S. Hrg. 99-725

MERGER LAW REFORM

HEARINGS

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

S. 2022

A BILL TO AMEND THE CLAYTON ACT REGARDING ANTITRUST ENFORCEMENT

AND

S. 2160

A BILL TO CLARIFY AND IMPROVE THE ANALYSIS OF MERGERS UNDER THE ANTITRUST LAWS

APRIL 9, MAY 12, AND 21, 1986

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CONTENTS

OPENING STATEMENTS

Page

Thurmond, Chairman Strom 1, 110, 243
Hatch, Hon. Orrin G 2
Metzenbaum, Hon. Howard M 2, 107
Murkowski, Hon. Frank H 108

PROPOSED LEGISLATION

S. 2022—A bill to amend the Clayton Act regarding antitrust enforcement 4
S. 2160—A bill to clarify and improve the analysis of mergers under the antitrust laws 15

CHRONOLOGICAL LIST OF WITNESSES

Wednesday, April 9, 1986

Baldrige, Hon. Malcolm, Secretary, Department of Commerce, Washington, DC; and Hon. Douglas H. Ginsburg, Assistant Attorney General, Department of Justice, Washington, DC 18
Turner, Donald F., of Wilmer, Cutler & Pickering; F.M. Scherer, of the Brookins Institution; and Joseph F. Brodley, of the Boston University School of Law 60

Monday, May 12, 1986

Ong, John D., chairman of the board, BF Goodrich Co., Akron, OH, on behalf of the Business Roundtable; James F. Rill, Collier, Shannon, Rill & Scott, Washington, DC, on behalf of the U.S. Chamber of Commerce; Eleanor M. Fox, professor of law, New York University School of Law, New York, NY; and James T. Halverson, Shearman & Sterling, New York, NY, on behalf of the Section of Antitrust Law, American Bar Association 111
Constantine, Lloyd, assistant attorney general for antitrust, State of New York, on behalf of the National Association of Attorneys General; John S. Satagaj, president, Small Business Legislative Council, Washington, DC; and Tom Wenning, executive vice president and general counsel, National Grocers Association, accompanied by Ronald Bloch, counsel 216

Wednesday, May 21, 1986

Oliver, Hon. Daniel, Chairman, Federal Trade Commission, Washington, DC, accompanied by Terry Winslow, Acting Director of the Bureau of Competition; and Dave Scheffman, Acting Director of the Bureau of Economics 244
Campbell, Thomas J., associate professor of law, Stanford University School of Law, Stanford, CA; Robert Pitofsky, professor of law and dean, Georgetown University Law Center, Washington, DC; James P. Melican, vice president and general counsel, International Paper Co., New York, NY; and Timothy P. Roth, professor and chairman, Department of Economics and Finance, University of Texas, El Paso, TX 256

ALPHABETICAL LISTING AND MATERIALS SUBMITTED

Baldrige, Hon. Malcolm: Testimony 18
Block, Ronald:
    Testimony 232

Page

- Block, Ronald—Continued
  - Statement of James Baska, vice chairman, National Grocers Association... 234
- Brodley, Joseph F.:
  - Testimony 92
  - Prepared statement 94
- Campbell, Thomas J.:
  - Testimony 256
  - Prepared statement 259
- Constantine, Lloyd:
  - Testimony 216
  - Prepared statement 218
- Fox, Prof. Eleanor M.:
  - Testimony 149
  - Prepared statement 151
  - The 1982 Merger Guidelines: When Economists are Kings, from the California Law Review, 1983 163
  - The New Merger Guidelines—a Blueprint for Microeconomic Analysis, from the Antitrust Bulletin, Fall 1982 169
  - Corporate Acquisitions and Mergers, 1985 173
- Ginsburg, Hon. Douglas H.:
  - Testimony 24
  - Prepared statement 25
- Halverson, James T.:
  - Testimony 177
  - Prepared statement 180
- Melican, James P.:
  - Testimony 287
  - Prepared statement 290
- Oliver, Hon. Daniel:
  - Testimony 244
  - Prepared statement 246
- Ong, John D.:
  - Testimony 111
  - Prepared statement 114
  - Letter to Senator Thurmond, June 4, 1986 131
- Pitofsky, Robert:
  - Testimony 274
  - Prepared statement 276
- Rill, James F.:
  - Testimony 132
  - Prepared statement 134
- Roth, Timothy P.:
  - Testimony 296
  - Prepared statement 298
- Satagaj, John S.:
  - Testimony 225
  - Prepared statement 228
- Scherer, F.M.:
  - Testimony 76
  - Prepared statement 78
- Turner, Donald F.:
  - Testimony 60
  - Prepared statement 63
- Wenning, Tom: Statement 232

APPENDIX

- Letter to Senator Thurmond from Hon. Malcolm Baldrige, Secretary of Commerce, June 18, 1986 307
- Letters to Hon. Malcolm Baldrige from:
  - G.J. Sella, Jr., March 14, 1986 308
  - Richard de J. Osboren, chairman and president, ASARCO, Incorp., April 24, 1986 309
  - Donald H. Trautlein, chairman, Bethlehem Steel Corp., March 6, 1986 310
  - R.A. Stranahan, Jr., chairman and chief executive officer, Champion Spark Plug Co., April 10, 1986 311
  - Charles E. Hugel, president, Combustion Engineering, April 8, 1986 312

Page

Letters to Hon. Malcolm Baldrige from—Continued
  George W. Mead, chairman of the board, Consolidated Papers, Inc., April 3, 1986 ... 313
  Alan E. Riedel, senior vice president, administration, Cooper Industries, April 1, 1986 ... 315
  Henry B. Schacht, chairman of the board, Cummins Engine Co., Inc ... 317
  Jacob Frank, vice president and general counsel, Data General, April 30, 1986 ... 319
  Robert W. Mahoney, president, Diebold, Incorp., March 31, 1986 ... 320
  Paul F. Oreffice, president, the Dow Chemical Co., April 7, 1986 ... 321
  E.G. Jefferson, chairman of the board, E.I. du Pont de Nemours & Co., March 11, 1986 ... 322
Letter to Hon. James A. Baker III, Secretary of the Treasury, from E.M. De Windt, chairman of the board, Eaton Corp., March 24, 1986 ... 323
Letters to Hon. Malcolm Baldrige, from:
  Charles F. Knight, chairman, Emerson Electric Co., March 31, 1986 ... 324
  C.C. Garvin, Jr., chairman of the board, March 18, 1986 ... 325
  Frank W. Luerssen, chairman, Inland Steel, April 3, 1986 ... 326
  H.A. Merlo, chairman and president, Louisiana-Pacific Corp., March 3, 1986 ... 327
  P. Roy Vagelos, M.D., president, Merck & Co., Inc., March 17, 1986 ... 328
  Charlton Dietz, vice president legal affairs, 3M Co., March 31, 1986 ... 329
  Allen E. Murray, chairman of the board, Mobil Corp., March 14, 1986 ... 331
  Richard J. Mahoney, president, Monsanto Co., March 13, 1986 ... 333
  Donald D. Lennox, March 20, 1986 ... 334
  C.D. Strang, chairman, Outboard Marine Corp., April 18, 1986 ... 335
  Paul G. Schloemer, president, Parker-Hannifin Corp., March 6, 1986 ... 336
  E.T. Pratt, Jr., chairman of the board, Pfizer Inc., March 26, 1986 ... 337
  John F. Bookout, president, Shell Oil Co., April 15, 1986 ... 338
  John P. Karalis, senior vice president and general counsel, Sperry Corp., April 21, 1986 ... 339
  Richard M. Furlaud, chairman, Squibb, Corp., April 8, 1986 ... 341
  Joseph P. Flannery, chairman, Uniroyal, Inc., March 31, 1986 ... 342
  John H. McConnell, Worthington Industries, Inc., March 17, 1986 ... 343
Letter to Kenneth Starling, chief antitrust counsel, Committee on the Judiciary, from Guy Miller Struve, chairman, Committee on Antitrust and Trade Regulation of the Association of the Bar of the city of New York, June 9, 1986. 344
Report on the Merger Modernization Act of 1986, by the Association of the Bar of the City of New York, Committee on Antitrust and Trade Regulation 345
  Concurring statement of Steven M. Edwards ... 361
  Concurrence and dissent of William F. Sondericker ... 364
  Dissent of Richard E. Carlton and Thomas P. Griesa ... 368
Letters to Senator Thurmond from:
  Dresser Industries, June 2, 1986 ... 369
  Exxon Corp., June 9, 1986 ... 370
  V.J. Adduci, Washington, counsel, Mack Trucks, Inc., June 4, 1986 ... 371
  David A. Ward, senior vice president law, Owens-Illinois, June 5, 1986 ... 372
  Donald E. Guinn, chairman, Pacific Telesis, June 16, 1986 ... 373
  D.M. Roderick, chairman, United States Steel Corp., June 12, 1986 ... 374
  Donald E. Guinn, chairman, Pacific Telesis, June 9, 1986 ... 375
  George M. Keller, chairman of the board, Chevron Corp., June 20, 1986 ... 376
  Edward Donley, chairman, Air Products & Chemicals, Inc., July 8, 1986 ... 377
  Edson W. Spencer, chairman, Honeywell Inc., July 18, 1986 ... 378

MERGER LAW REFORM—S. 2022 AND S. 2160

WEDNESDAY, APRIL 9, 1986

U.S. Senate,
Committee on the Judiciary,
Washington, DC.

The committee met, pursuant to notice, at 10:35 a.m., in room SD-106, Dirksen Senate Office Building, Hon. Strom Thurmond (chairman of the committee) presiding.

Also present: Senators Hatch, Specter, McConnell, Heflin, Simon, and Metzenbaum.

Staff present: Kenneth G. Starling, chief antitrust counsel; Dee Benson, Linda Spector, counsel; Laurie Westley, Karen Kremer, minority counsel; and Eddie Correia, minority counsel.

OPENING STATEMENT OF CHAIRMAN STROM THURMOND

The **Chairman**. The committee will come to order. Today the committee is continuing an important series of hearings focusing primarily on the administration's comprehensive antitrust reform proposals which I recently introduced.

Our hearings will also cover the proposals introduced by Senator Metzenbaum. This hearing is the first hearing devoted to the administration's proposal regarding the merger law standard. I am happy to begin consideration of this proposal, and I look forward to a set of very informative hearings on these timely antitrust issues.

The administration has recommended that Congress amend the language of the Clayton Act by which mergers are judged. The merger law is enforced by both the Justice Department and the Federal Trade Commission, and the administration's proposed amendment of the Clayton Act is said to approximate the current enforcement standards.

The language of section 7 of the Clayton Act is broad language which, if read literally, can be invoked to prohibit acquisitions that may lessen competition, without any requirement that the mergers pose real risk of actually harming competition or consumers in any way. In the past, this standard may have been applied in a way that failed to distinguish procompetitive mergers from anticompetitive mergers.

For years, the merger enforcement authorities have tried to provide guidance to the business community by the process of merger analysis. In merger analysis, the courts and the administration have tried to bridge the gap between predictability and the need to evaluate all relevant evidence bearing on the consequences of a merger.

At one point, the market shares held by the merging firms were heavily emphasized in merger analysis. While this approach provides predictability, it may have failed to take full account of other factors bearing on the competitive effect of a merger.

Since then, merger analysis has evolved in a way which still takes market shares into account but permits evaluation of other factors, such as the extent of foreign competition facing merger firms. The basis of the administration proposal is that these other factors in merger analysis helped to distinguish between mergers that would probably benefit consumers and those that will probably harm consumers.

The administration has suggested that this is an appropriate time to amend the language of the Clayton Act to codify this more enlightened form of merger analysis.

Without objection, Senator Hatch's and Senator Metzenbaum's opening statements will be inserted in the record at this point. Also copies of S. 2022 and S. 2160 will be included in the record.

[The aforementioned material follows:]

OPENING STATEMENT OF SENATOR ORRIN G. HATCH

Mr. Chairman, in my view, S. 2160 represents a needed modernization of Section 7 of the Clayton Act. It specifies sound economic criteria for all courts to consider in deciding merger cases.

It has been 72 years since Section 7 of the Clayton Act was enacted. As with all of the antitrust laws, the fundamental goal of Section 7 is to ensure free competition. As presently applied, however, Section 7 may be invoked to discourage and prohibit mergers which actually foster, rather than retard, competition. This new bill remedies the problem by clarifying the standard under which mergers are tested. It gives the courts clear directions. It allows Courts and Federal agencies to consider all relevant economic factors in making their decisions regarding mergers.

I think it is important to note that this bill does not change the antitrust laws. It clarifies and strengthens them. The bill is not designed in any way to allow mergers that would harm competition, but it does recognize modern economic reality and opens the door a little more widely for efficient, procompetitive mergers to occur.

One reality of the modern business world is the significant competition our American industries face from their foreign counterparts. American companies need to have the freedom to restructure their operations as necessary to increase productivity and remain viable competitors in world markets. We cannot afford to have Section 7 applied with a vision that doesn't focus very well beyond our own domestic shorelines. These new guidelines do a good job of clarifying the proper distinction between procompetitive and anticompetitive mergers. With this law, the courts will have a welcome new analytical framework, which requires consideration of "all economic factors relevant to the affected markets," including "the ease or difficulty of entry by foreign or domestic firms."

In fact, there have been a number of decisions in recent years which have applied the sensible analysis contained in this proposal. But we cannot rely on case by case progress to establish such an important analytical approach. This is an area where legislation is needed to eliminate confusion, give guidance, and foster a healthy and competitive marketplace.

I applaud the efforts of the committee's distinguished chairman, Senator Thurmond, in formulating this bill. I also want to compliment Secretary Baldrige for his excellent and tireless commitment to sensibly improving our antitrust laws. I look forward to hearing his testimony this morning. Thank you, Mr. Chairman.

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

The administration has proposed to change in a fundamental way the standard for illegal mergers in this country. Now, a merger is illegal if it may substantially lessen competition. The new standard recommended by the administration doesn't even have the word "competition" in it. It is a vague and untested standard that offers no certainty as to what it means except that businesses will find it much easier to combine even if competition would be reduced.

The administration also has proposed to promote mergers in industries hurt by foreign competition in order to reduce the trade deficit.

I have to give the President, the Department of Commerce, and the Justice Department credit. They have come up with something new to blame for record trade deficits. At one time it was environmental regulations that were keeping American firms from being competitive with the Japanese. Then it was workplace safety regulations. Then it was the Tax Code. Now it's antitrust. The administration should at least get some credit for creative thinking.

The fact is, though, antitrust has nothing to do with the trade deficits. We have become a debtor nation for the first time in history during a period when the antitrust laws have been ignored by the enforcement agencies. In 1980 we had 94 mergers over $100 million in value. Our trade deficit was $25.4 billion. In 1985, we had 268 mergers over $100 million in size, an all time record. Our trade deficit was $124.3 billion.

Even William Baxter, who is no friend of the antitrust laws, said this idea was atrocious. A report of the Federal Trade Commisson said this approach would make us less competitive, not more.

I suspect the administration would like to point the finger of blame for record deficits at anything besides its own trade policies.

Under this administration we have seen the 16 largest mergers in the history of this country. We have seen a new record each year for the number of mergers over $100 million in size. And, at the same time, we have seen a drastic reduction in the number of merger cases brought and the number investigated. Now the administration wants to change the standard that has been on the books since 1914.

Let's be frank. The administration loves bigness. It would be content if our major industries consisted of only a handful of big companies. It has promoted hunderds of mergers with a hands-off attitude that is bad for business and consumers both. Now, it wants to make this anything-goes merger policy permanent by leaving future administrations with toothless laws.

The administration has its logic totally backward. Antitrust is the key to the free enterprise system, not a threat to it. I will opose any efforts to weaken the standards for mergers. I will also oppose a policy of allowing our major industries to consolidate to a handful of giant companies in a futile and foolish effort to improve our international competitiveness.

II

99TH CONGRESS
2D SESSION

S. 2022

To amend the Clayton Act regarding antitrust enforcement.

IN THE SENATE OF THE UNITED STATES

JANUARY 27, 1986

Mr. METZENBAUM introduced the following bill; which was read twice and referred to the Committee on the Judiciary

---

A BILL

To amend the Clayton Act regarding antitrust enforcement.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Antitrust Improvement Act of 1986".

REDRESS FOR CONSUMERS

SEC. 2. (a) Section 4C(a) of the Clayton Act is amended—

(1) in paragraph (1), by striking out "Any" and inserting in lieu thereof "The Attorney General, the Federal Trade Commission, or any";

(2) in paragraph (1), by striking out "such State," each place it appears and inserting in lieu thereof "the United States or such State, as appropriate,";

(3) in paragraph (1), by inserting before the period at the end of the first sentence ", including injury resulting from indirect purchases";

(4) in paragraph (2), by inserting "United States, or the" before "State";

(5) in paragraph (2), by striking out "including" and inserting in lieu thereof "and in the case of a State,"; and

(6) in paragraph (2), by adding at the end thereof the following: "The court, in its discretion, may order the distribution of the award in a manner that is just and equitable to those persons or the class of persons on whose behalf the action was brought.".

(b) Section 4C(b) of the Clayton Act is amended—

(1) in paragraph (1) by inserting "Attorney General, the Federal Trade Commission, or the" before "State";

(2) in paragraph (1) by inserting ", as appropriate," after "general"; and

(3) in paragraph (2) by striking out "State claim" and inserting in lieu thereof "claim of the United States or the State".

(c) Section 4C(d) of the Clayton Act is amended by inserting "Attorney General, the Federal Trade Commission, or the" before "State".

(d) Section 4C of the Clayton Act is amended by adding at the end thereof the following:

"(e)(1) If the Attorney General, the Federal Trade Commission, or a State attorney general asserts a claim for damages based on indirect purchases pursuant to subsection (a)(1), the defendant shall be entitled to allege, as a partial or complete defense to a claim by . direct purchaser based on the same or substantially the same alleged conduct, that some or all of what would otherwise constitute direct purchaser's damages were passed on by the direct purchaser to persons on whose behalf the claim for damages from indirect purchases was brought.

"(2)(A) Any person entitled to maintain an action pursuant to subsection (a)(1), alleging injury from indirect purchases, may intervene in any action under section 4 alleging injury from direct purchases based on the same or substantially the same alleged conduct, if a request for such intervention is made within six months after the date of the filing of the initial action. The failure to request intervention in a pending action by any person alleging injury from indirect purchases, within such time, shall constitute a bar to a claim by such person for injury from indirect purchases based on the same or substantially the same alleged conduct.

"(B) Any person initiating an action under section 4 may intervene in any action under subsection (a)(1) which alleges injury from indirect purchases based on the same or substantially the same alleged conduct.

"(C) Upon a request made by the defendant, the court shall order the consolidation of any pending actions pursuant to subsection (a)(1) alleging injury from indirect purchases and any other action under section 4 based on the same or substantially the same alleged contract, combination, or conspiracy.

"(3) Upon the initiation of any action pursuant to subsection (a)(1) alleging injury from indirect purchases, the Attorney General, the Federal Trade Commission, or State attorney general, as the case may be, shall provide reasonable public notice of the allegations of the suit and, to the extent possible, a general description of any direct purchasers who may be entitled to maintain an action under section 4.".

DAMAGES FOR INJURY TO THE UNITED STATES

SEC. 3. Section 4A of the Clayton Act is amended by striking out "actual" and inserting in lieu thereof "threefold the".

DIVESTITURES

SEC. 4. The Clayton Act is amended by adding between section 7A and section 8 the following:

"CONSENT AGREEMENTS AND DECREES AND ORDERS IN ACQUISITIONS

"7B. (a) With respect to any acquisition—

"(1) no Commission consent agreement,

"(2) no consent decree proposed to a court of competent jurisdiction by the Commission or the Attorney General, and

"(3) no order issued by either the Commission or a court

which provides for the divestiture of any part of the assets of a party to such acquisition shall become final before the required divestiture has been approved by the Commission or the court. If the divestiture required by a consent agreement, consent decree, or order is not approved, such agreement, decree, or order may be rescinded by the Commission or court and the Commission or the Attorney General may petition the court for further relief or, if appropriate, initiate an action or proceeding to consider the legality of the acquisition and the need for further relief.

"(b) The provisions of consent decrees proposed by the Attorney General or the Commission and consent agreements proposed by the Commission shall be enforceable, consistent with the terms of the agreement or proposed decree, after agreement by the persons subject to the provisions of the consent decree or agreement, in accordance with procedures authorized by law for enforcement of final orders and decrees.

"(c) No divestiture shall be deemed an acceptable remedy for an acquisition which substantially lessens competition unless the divestiture fully restores competition lost as a result of the acquisition and there is a substantial likelihood that any buyer of divested assets will be a viable competitor for the foreseeable future. In approving divestitures, the Attorney General, the Federal Trade Commission, or the court, as appropriate, shall insure that reasonable steps are taken to protect the interests of affected employees and to preserve employment consistent with the full restoration of competition.".

COST REDUCTION AND IMPROVING COMPETITION

SEC. 5. (a) The Federal Trade Commission and the Attorney General shall, pursuant to section 7A(d) of the Clayton Act, promulgate rules within 180 days after the date of enactment of this Act, specifying information to be provided by persons, subject to subsection (a) of section 7A of such Act, who claim that an acquisition of securities or assets or a joint venture will reduce the costs of operation and thereby promote competition. Such information shall be limited to specific reductions in the costs of production, distribution, transportation, or, in exceptional cases, other factors directly related to firm operations. The Federal Trade Commission and the Attorney General shall take into account such information in determining whether to initiate an action under any of the antitrust laws or the Federal Trade Commission Act.

(b) In any case in which the Federal Trade Commission or the Attorney General declines to initiate an action regarding an acquisition or joint venture on the grounds that the acquisition or joint venture is likely to promote competition through reducing costs, the agency primarily responsible for the antitrust review shall certify that the parties have demonstrated by clear and convincing evidence that—

(1) costs of operation are likely to be substantially reduced directly as a result of the proposed acquisition or joint venture,

(2) the cost reduction is likely to lead to reduced prices, and promote competition, and

(3) there is no reasonable alternative method for achieving such cost reductions other than the proposed acquisition or joint venture.

(c) In the event such a certification is made, it may be offered by any party to any action under the antitrust laws or the Federal Trade Commission Act alleging that the acquisition or joint venture violates such laws and shall be relevant in determining whether the acquisition or joint venture may substantially lessen competition.

FOREIGN COMPETITION

Sec. 6. The Clayton Act is amended by adding between section 7B, as added by this Act, and section 8, the following:

"FOREIGN COMPETITION

"Foreign competition shall be considered in determining whether an acquisition or joint venture may substantially lessen competition to the extent that—

"(1) there is a substantial likelihood that foreign sales in the United States will increase significantly in response to a reduction in competition resulting from the acquisition or joint venture, and

"(2) such increase will substantially offset any harm from such reduction.".

TIME FOR REVIEW OF MERGERS

Sec. 7. (a) Section 7A(b)(1)(B) of the Clayton Act is amended by striking out "(or in the case of a cash tender offer, the fifteenth day)".

(b) Section 7A(e) of the Clayton Act is amended—

(1) by striking out "(or in the case of a cash tender offer, the 15-day waiting period)" each place it appears,

(2) in paragraph (2) by striking out "(or in the case of a cash tender offer, 10 days)", and

(3) by adding at the end thereof the following new paragraph:

"(3) If, as a result of an acquisition to which subsection (a) applies the acquiring person would hold an aggregate total amount of the voting securities or assets of the acquired person in excess of $1,000,000,000 in value, the additional waiting period provided in paragraph (2) of this subsection shall be 60 days.".

INFORMATION TO STATE ATTORNEYS GENERAL

Sec. 8. Section 7A(h) of the Clayton Act is amended by inserting before the period at the end thereof the following: ", or to officers and employees of appropriate Federal law enforcement agencies or to any officer or employee of any State law enforcement agency upon the prior certification of an officer of any such Federal or State law enforcement agency that such information or documentary material will be maintained in confidence. The maintenance of confidence requirement does not preclude any use of such information or documentary material for official law enforcement purposes, including the preparation of comments regarding consent agreements or decrees proposed by the Commission or the Attorney General under any of the antitrust laws or the Federal Trade Commission Act".

PRIVATE REMEDIES

Sec. 9. Section 16 of the Clayton Act is amended by adding at the end thereof the following: "Injunctive relief under this section may include equitable remedies of dissolution, rescission, partial divestiture, and related equitable remedies.".

INTEREST ON DAMAGE AWARDS

SEC. 10. (a) Section 4(a) of the Clayton Act is amended by—

(1) inserting after "sustained,", in the first sentence, the following: "simple interest on the actual damages for the period beginning on the date of service of such person's pleading setting forth a claim under the antitrust laws or the Federal Trade Commission Act and ending on the date of judgment, such interest to be adjusted by the court if it finds that the award of all or part of such interest is unjust under the circumstances,"; and

(2) striking out, beginning with "The court may" in the second sentence, all that follows through the end of such subsection.

(b) Section 4A of the Clayton Act is amended by—

(1) inserting after "sustained," in the first sentence, the following: ", simple interest on actual damages for the period beginning on the date of service of the pleading of the United States setting forth a claim under the antitrust laws and ending on the date of judgment, such interest to be adjusted by the court if it finds that the award of all or part of such interest is unjust under the circumstances,"; and

(2) striking out, beginning with "The court may" in the second sentence, all that follows through the end of such section.

(c) Section 4C(a)(2) of the Clayton Act is amended by—

(1) inserting after "this subsection," the following: "simple interest on the total damage for the period beginning on the date of service of the pleading of the United States or the State setting forth a claim under the antitrust laws and ending on the date of judgment, such interest to be adjusted by the court if it finds that the award of all or part of such interest is unjust under the circumstances,"; and

(2) striking out, beginning with "The court may" in the second sentence, and all that follows through the end of such subsection.

II

99TH CONGRESS
2D SESSION

S. 2160

To clarify and improve the analysis of mergers under the antitrust laws.

IN THE SENATE OF THE UNITED STATES

MARCH 7 (legislative day, FEBRUARY 24), 1986

Mr. THURMOND (for himself, Mr. LAXALT, Mr. HATCH, Mr. EAST, Mr. MCCONNELL, and Mr. MURKOWSKI) (by request) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

---

A BILL

To clarify and improve the analysis of mergers under the antitrust laws.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Merger Modernization Act of 1986".

SEC. 2. Section 7 of the Clayton Act (15 U.S.C. 18) is amended by—

(a) in the first paragraph—

(1) striking out "the effect of" and inserting in lieu thereof "there is a significant probability that";

(2) striking out "may be" and inserting in lieu thereof "will"; and

(3) striking out "to lessen competition, or to tend to create a monopoly" and inserting in lieu thereof "increase the ability to exercise market power";

(b) in the second paragraph—

(1) striking out "the effect of" and inserting in lieu thereof "there is a significant probability that";

(2) striking out "may be" and inserting in lieu thereof "will"; and

(3) striking out "to lessen competition, or to tend to create a monopoly" and inserting in lieu thereof "increase the ability to exercise market power"; and

(c) in the third paragraph—

(1) striking out "the substantial lessening of competition" in the first sentence and inserting in lieu thereof "a substantial increase in the ability to exercise market power"; and

(2) striking out "lessen competition" in the second sentence and inserting in lieu thereof "increase the ability to exercise market power"; and

(d) inserting immediately after the third paragraph the following new paragraph:

"For purposes of this section, the ability to exercise market power is defined as the ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time. In determining whether there is a significant probability that any acquisition will substantially increase the ability to exercise market power, the court shall duly consider all economic factors relevant to the effect of the acquisition in the affected markets, including (i) the number and size distribution of firms and the effect of the acquisition thereon; (ii) ease or difficulty of entry by foreign or domestic firms; (iii) the ability of smaller firms in the market to increase production in response to an attempt to exercise market power; (iv) the nature of the product and terms of sale; (v) conduct of firms in the market; (vi) efficiencies deriving from the acquisition; and (vii) any other evidence indicating whether the acquisition will or will not substantially increase the ability, unilaterally or collectively, to exercise market power.".

The **Chairman**. We have a most distinguished group of witnesses to assist us in our consideration of these proposals. On behalf of the administration, we have the Honorable Secretary of Commerce, Malcolm Baldrige. We also have Assistant Attorney General Douglas Ginsburg, who will give a statement on behalf of Attorney General Meese.

Following these witnesses, we will have a panel of commentators: The Honorable Mr. Donald Turner, head of the Antitrust Division under President Johnson from 1965 to 1968, coauthor of the principal treatise on antitrust law and currently in practice at Wilmer, Cutler and Pickering here in Washington. Mr. Turner was kind enough to join us at our first hearing on antitrust remedies, and we welcome him back today. Prof. Fred Scherer, former Director of the FTC's Bureau of Economics, author of several books on antitrust economics and now professor of economics at Swarthmore College. Prof. Joseph Brodley, distinguished professor of law at Boston University and author of numerous articles on merger law.

We welcome you all. And we will begin with Secretary Baldrige. And Mr. Secretary, again, I want to welcome you here, and you may now proceed.

STATEMENT OF HON. MALCOLM BALDRIGE, SECRETARY, DEPARTMENT OF COMMERCE, WASHINGTON, DC; AND HON. DOUGLAS H. GINSBURG, ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF JUSTICE, WASHINGTON, DC

Mr. **Baldrige**. Thank you very much, Mr. Chairman. I welcome this opportunity to appear before you and this committee to comment on S. 2160, the administration's proposal to amend section 7 of the Clayton Act.

Some say this proposal will permit anticompetitive mergers. I do not believe that. Those people either do not understand how competition works, or wish to protect special interests at the expense of competition and consumer welfare.

Our purpose in seeking an amendment to section 7 is two-fold: To create certainty in the language, and opportunities for firms to merge to improve their competitive ability.

I think every member of this committee shares this goal. And let me explain, please, how S. 2160 will achieve that.

First, let me make clear from the start, I speak only of mergers and joint ventures which are proposed to achieve economies—in production, in distribution, in research and development, or in any other level of corporate activity. This means mergers, usually horizontal, and joint ventures between firms in the same or in related industries.

I am not talking about conglomerate mergers which usually occur between firms in unrelated industries. I am concerned about horizontal mergers among competitors.

Senate bill 2160 updates our principal merger statute, section 7 of the Clayton Act. It substitutes for the vague, open-ended language of section 7 a more clearly defined standard that provides specific direction to courts and businessmen. Mergers will be prohibited if they create a significant probability of market power.

Market power is a term easily understood by businessmen. It means the power to hold prices above competitive levels.

The bill lays out six economic factors the courts and antitrust enforcement agencies must consider in determining whether a given merger will increase the firm's ability to maintain prices above competitive levels.

These six are:

One, the number and size distribution of firms in the market, and the effect on them of the proposed merger.

Two, the ease or difficulty of entry into the market by foreign or domestic firms.

Three, the ability of smaller firms in the market to increase production.

Four, the nature of the product, and the terms of sale.

Five, the conduct of firms in the market, and

Six, the efficiencies which would be derived from the acquisition.

In addition, the bill requires the courts or the anti-trust enforcement agencies to consider, and I quote, "any other evidence" which will indicate whether or not the merger will result in market power. So for the first time, judges, business, and lawyers will be able to look to the law and know that it recognizes the importance of efficiencies and the influence of foreign competition.

I believe we can agree that section 7, as it is now written, is about as vague and clumsy as a standard can be. Businessmen do not understand it. The courts have abandoned their initial strict interpretations. And the lawyers, upon whose translation we all must rely, are often as confused as we are.

I would like to eliminate the need for a translation. I would like the message to business to be clear: Consider a merger if you think it will increase your competitiveness. Unless there is a significant probability that your business will have the power, alone or with other firms, to overcharge consumers, a merger will be lawful. And to achieve this goal, we need to amend section 7 of the Clayton Act.

Let me explain, please. A chief executive officer sees an opportunity to improve his bottom line by buying the production facilities of another company in the same line of business. That CEO doesn't care if conglomerates, or firms in unrelated businesses, have been buying and divesting. He does not care if some horizontal mergers in other industries in other times have not been successful. He knows his own business and his own cost figures. He knows that he is responsible for his company's performance against his competitors, whether those competitors are foreign or domestic firms. He—not Government—is the best one to judge whether to try a merger. It is a business decision.

But the decision is not the chief executive officer's alone. And it is a stressful decision at every level. It affects management, stockholders, employees, and possibly consumer preference. The last thing a CEO needs is uncertainty over whether the transaction will be challenged either by Government or a competitor.

The concerns of employees, management, and the stockholders are legitimate. A CEO can manage those. But he cannot manage the legal uncertainty.

To lessen that legal uncertainty, this CEO calls in lawyers. And the lawyers explain that the language of section 7—words like "may lessen competition," or "tend to create a monopoly,"—have meant different things to different people at different times. What they might mean now is suggested by the guidelines in use at the moment.

Sometimes the courts follow the guidelines. Sometimes they do not. Competitors can go looking for a court which does not. They have lawyers, too. And the guidelines are only that, and can always be changed.

The CEO must deal with all of these factors, and make a decision—propose a merger, or not. All of this can translate, obviously, into no merger, another lost opportunity.

What concerns me the most is that such a decision is no longer a business decision, but a legal one. The CEO cannot be sure of the legal standard, and cannot himself decide whether his proposal does or does not violate that legal standard. And the lack of understanding makes this process, much like a moving target, all the riskier.

The changes we have proposed, Mr. Chairman, in section 7 will help greatly. First, the bill would make the new standard law, and put it in black and white. The law would bind all courts and subsequent Government enforcers.

Second, and more important, the bill would describe the line between a lawful merger and an unlawful one in terms a CEO could himself understand. That may reduce legal fees, but it certainly helps business costs. The CEO knows his competition, whether he could maintain a price increase in the market for any period of time without losing too many customers. He should know at just what price he can expect a flood of new entrants in his market, or an increase of production by other competitors.

As much as some CEO's might like to have that much market power, I think they will understands the consequences if that line is crossed.

Rational enforcement policy by this administration may have lessened uncertainty. But enough uncertainty still exists to stop some mergers before they get out of the chute, particularly among small-to-medium-sized firms who cannot afford the enormous cost of sophisticated merger counsel. I am certain that making these changes part of the law can only increase the quality of the chief executive officer's business decisions. It becomes his decision—a business decision, and not a legal one.

We will all benefit from an amended section 7. Economists tell me that mergers can indeed significantly improve firm efficiencies and lower costs. As a businessman, I understand that one way to meet competition is to pass those kinds of savings on to customers in the form of lower prices. Senate bill 2022, Senator Metzenbaum's bill to amend section 7, recognizes this fact.

Now, it is true that not all mergers result in efficiencies; but the Government should not be in the business of predicting which ones will and which ones will not. The merger should be allowed unless it poses a real threat to competition and to consumers.

Mr. Ginsburg can assure you that the changes we have proposed for section 7 will continue to protect competition. As a lawyer, he can explain that Senate bill 2160 only codifies the best of present enforcement policy.

Enforcement practice since the 1982 guidelines has been, in effect, a test period. This administration has tested the standard we are now proposing as law. Have we seen a decrease in competition? No. On the contrary, the success of imports demonstrates only too well that competition for American buyers is strong, except in industries that benefit from tariff or quota barriers.

The consumer today can choose low-priced goods from all over the globe. The standard works. I invite anyone, Mr. Chairman, who condemns this present merger policy as administered by the Department of Justice and the Federal Trade Commission under the guidelines, to show how it has increased concentration, harmed competition, or threatened the consumer.

Finally, Mr. Chairman, let me explain what this proposal will not do. We are not opening a floodgate to anticompetitive mergers. Section 7 will still stop mergers that pose a real threat to competition. The courts will have a clear standard that distinguishes between those that pose that threat and those that do not. The Hart-Scott-Rodino review process will remain in place to allow premerger analysis.

Sections 1 and 2 of the Sherman Act will remain to protect both business and consumers from anticompetitive activities, if any do occur. Of course, we should hit companies hard under the Sherman Act if they fix prices or otherwise collude. These actions not only lead to less efficiency, they hurt the consumers.

Nor are we inviting a market structure in which big business overwhelms smaller or medium-sized firms. Any firm of any size which operates efficiently will survive in a marketplace which does not have government interference.

Recent increases in conglomerate merger activity have nothing to do with this proposal. Conglomerate mergers do not present competitive problems. Mr. Chairman, let me emphasize, we do not suggest, and never have suggested, merger reform as a cure-all for American trade problems. That is a strawman argument put up by the opponents. More efficiency-producing mergers will help American business to lower prices.

Other efforts, such as reducing the deficit, seeking a more sensible alignment of the dollar, and actively identifying and eliminating unfair trade practices, will obviously make more noticeable improvements in our trade balance. These are long-term efforts which involve relations with other countries.

In contrast to these other measures, amending section 7 is the unilateral and relatively quick step. It does not violate the GATT. It requires no multilateral negotiations, needs no treaty or tradeoffs. We can do it now. When faced with intense competition, we must seek every available advantage.

This proposal will not shift any burdens of proof. Present practice is only made law. The Attorney General has assured me that this proposal will not harm small business, and I do not see how it will, either.

We are here simply to create the opportunity for a rational businessperson to attempt a procompetitive merger if it will not harm competition because we cannot go back to the 1950's. The world has changed; the world will change more. Now, if an American company, even a large one, tries to keep prices above competitive levels, it loses business to import competition. Ask the firms who make VCR's, or stereos, or steel, or shoes, or semiconductors.

Neither mergers nor size are automatically anticompetitive. Those who ignore this basic change actually harm competition and the health of our economy. The statute which shapes the structure of the economy must reflect this fact in black and white.

In 1914, when Congress first took up section 7, William Raymond Green, a Representative from Iowa, offered this judgment: "The result," he said, "if the bill becomes a law, will be to create doubt and uncertainty. The businessman embarking upon a voyage of trade will not know which way to steer his vessel. The construction of the act will necessarily be involved in a fog of doubt, and until its uncertainties are settled the most honest man may be in fear and the active will hesitate."

Mr. Chairman, we have called for reform of section 7 because the world has changed. But one thing remains the same. A law which so strongly influences the health of our economy must clearly say what is legal and what is not, in words that people can understand. We can accomplish this now. Let us not be stopped by those who are preoccupied with outdated notions about firm size.

As we near the 100th anniversary of the Sherman Act, it is time for us to reflect on its original purpose, which was to stimulate and protect competition. Amending section 7 of the Clayton Act as we have proposed will stimulate competition among firms.

We can no longer protect the inefficient, and Senate bill 2160 will only benefit the consumer and strengthen our economy.

Mr. Chairman, thank you very much. This concludes my prepared remarks.

The **CHAIRMAN**. Thank you very much, Mr. Secretary. I have a few questions here I would like to propound before we move on to Mr. Ginsburg.

Senator **HATCH**. Mr. Chairman, could I just ask——

The **CHAIRMAN**. Excuse me, Senator Hatch. I didn't realize you had come in. I will be glad for you to make any statements you wish.

Senator **HATCH**. Well, thank you. I would like to welcome both the Secretary and Mr. Ginsburg to the committee. I appreciate the efforts that you have made, Mr. Chairman. I would just ask that you place my statement in the record.

The **CHAIRMAN**. Without objection, that will be done.

Senator **HATCH**. I want to compliment both of you for the innovative, creative way you are trying to help resolve these problems, and some of the suggestions that have been made here. And my statement does back you in your effort.

We appreciate what you are doing. I cannot stay longer, but I will read both of your statements. I have listened to yours, Mr. Secretary, and I will certainly read yours, Mr. Ginsburg, because I have an intense interest in this area. It is certainly time, after 72 years, that we make some appropriate changes.

It is time for us to give the courts some guidance in these areas. I think you are making a real effort to do so.

I want to thank you, Mr. Chairman, and thank both of you for testifying, and the other witnesses as well.

The CHAIRMAN. Thank you, Senator Hatch. And if you can get back, we will be delighted to have you come back.

Now, Mr. Secretary, the bill would list specific factors to be taken into account in analyzing mergers. Those factors include efficiencies in foreign competition. In this regard, I have three questions.

First, do you think that the list of factors in the bill is sufficient to take account of the role of pressure from foreign competition on the effects of mergers?

Mr. BALDRIGE. Yes, sir; I do. One of the six necessary economic factors that the courts and the antitrust enforcement agencies must consider is the ease or difficulty of entry into the market by foreign or domestic firms. So we should see that provision, because it must be considered, as including the possibility of foreign competitors, even if they are not now in a particular U.S. marketplace, their ability to enter and compete

And we see foreign competition often enough that I think it is a very important point. In short, if anybody, any group of companies, U.S. companies, did try to raise prices above a market level, I think it would take only a very short time, Mr. Chairman, before foreign competition would be in here in a hurry; 75 percent of all of the products made in the United States is subject to foreign competition now. Foreign competitors know full well now how to market and advertise, sell, and in some cases manufacture in the United States.

But I think this provision would take care of that, sir.

The CHAIRMAN. The second question is, could you describe the kinds of consideration that you think should and would be included as efficiencies deriving from the acquisitions under the bill?

Mr. BALDRIGE. That would be a long list, indeed, Senator.

The CHAIRMAN. Could you try to furnish that for the record?

Mr. BALDRIGE. Yes. I would just comment briefly, it could include efficiencies—for example, an overhead reduction. We see in this country probably higher overhead costs, administrative costs, than a good many of our foreign competitors have. And this would enable mergers to reduce those overhead costs.

It could reduce advertising costs. It could reduce manufacturing costs by combining the best facilities, phasing out the ones that were noncompetitive. And on and on.

But I would be glad to make a complete list available to you, for the record.

The CHAIRMAN. Thank you. My third question was, in your view, is this enumeration of factors sufficient to allow domestic companies to plan and defend procompetitive acquisitions and consolidations?

Mr. BALDRIGE. Yes; I think it is, Senator. The six areas that the courts and the antitrust enforcement agencies must consider are a very comprehensive list. Any competitor's interests would be protected.

But I think what we are trying to do here is to protect the consumer, not individual companies. The fact is that the seventh requirement that the bill insists on is that the courts or the antitrust enforcement agencies also should consider any other evidence which would indicate whether or not the merger will result in market power, the ability to raise prices above competitive levels. That is a very comprehensive list of considerations for the court to take into account, and I think would adequately protect consumers as a result

The CHAIRMAN. Thank you, Mr. Secretary.

Mr. Ginsburg, I believe you are representing Attorney General Meese at this hearing. And we will be very pleased to hear from you now.

Mr. GINSBURG. Thank you very much, Mr. Chairman.

The CHAIRMAN. And he is the Chief of the Antitrust Division in the Department of Justice.

Mr. GINSBURG. Thank you, Mr. Chairman.

The CHAIRMAN. I was just wondering, would you care to put your entire statement in the record and then take about 7 to 8 minutes and summarize?

Mr. GINSBURG. That would be fine. Thank you.

The CHAIRMAN. Give the thrust of it.

Mr. GINSBURG. Yes. The Attorney General's prepared statement will be made available for the record.

The CHAIRMAN. Without objection, his entire statement will go in the record.

STATEMENT OF HON. DOUGLAS H. GINSBURG

Mr. GINSBURG. The Attorney General and I very much appreciate this opportunity to participate in this hearing. He is unavoidably absent this morning, and asked me to convey his best regards and his appreciation for this opportunity.

Before turning to the specifics of S. 2160, the Merger Modernization Act of 1986, I would like to address one or two misperceptions that have arisen in the public discussion of mergers and acquisitions and that should be corrected before this legislation can be correctly understood.

Some accounts in the popular press of recent mergers would suggest that we are in the midst of an uncontrollable merger mania. I think a look at the statistics on mergers helps to put the present situation in a more balanced perspective.

If we look first at the number of transactions, we find that there were, in fact, as many or more mergers and similar transactions each year from 1967 to 1973, as there were in 1985.

If we look instead at the dollar value of these transactions, we find of course that the amounts involved have indeed increased. I think that is what accounts for much of the press attention to the larger transactions.

Notwithstanding the larger dollar amounts involved in some of the more well publicized mergers, the fact is that aggregate concentration in the U.S. economy has not been increasing, and has, in fact, been decreasing, as a review of the data will reveal.

With the chairman's permission, I will refer to two charts which will also be supplied in a form suitable for inclusion in the record.

Senator SPECTER. They will be made a part of the record, without objection.

Mr. GINSBURG. Thank you, Senator.

[Prepared statement and letter follow:]

DRAFT

Statement of

The Honorable Edwin Meese III
Attorney General of the United States

Before the

Committee on the Judiciary
United States Senate

Concerning

S. 2160
The Merger Modernization Act of 1986

April 9, 1986

Mr. Chairman and Members of the Committee:

I am pleased to have the opportunity to appear before the Committee to testify on S. 2160, the "Merger Modernization Act of 1986." This bill, introduced by the Chairman on behalf of the Administration, would make timely and important improvements in the statutory framework within which mergers and acquisitions are reviewed. It would amend section 7 of the Clayton Act--the primary federal statute pertaining to mergers--in order that the statute distinguish more clearly between procompetitive, efficiency-enhancing mergers, on the one hand, and mergers that create a significant probability of increasing prices to consumers, on the other.

Corporate mergers and acquisitions have been the subject of considerable discussion of late in the popular press. Before turning to the specifics of our bill, I would like to address some of the misperceptions that have arisen in the public discussion of mergers and acquisitions.

It is now widely understood that mergers can and often do perform beneficial functions in the economy. First, mergers can result in real resource savings for the economy, through the realization of joint operating efficiencies, economies of scale, economies of scope, and financial economies. Second, they can provide access to resources for both acquirors and target companies that lead to new or better products and services than either firm alone could develop successfully.

Third, because there is a vigorous and competitive market for corporate control, the possibility of an unfriendly takeover helps to discipline managers to serve stockholder interests better. It also leads potential acquirors to identify undervalued assets, causing them to be more appropriately valued or redeployed in a more efficient use.

Some observers of corporate merger activity contend that mergers are irrational or counterproductive, based on their identification of particular mergers as failures. Such an anecdotal approach to understanding mergers is seriously flawed as a basis for forming public policy. Of course, not every merger has the beneficial effects that the parties involved had hoped for and expected. This, however, amounts only to saying that business people sometimes make mistakes. That is quite irrelevant to antitrust policy. In enforcing the merger laws, the government does not and cannot act as a management consultant or investment advisor to second-guess the wisdom of business decisions. We are empowered to prevent a merger only where there is a demonstrable threat to competition, and that is as it should be.

In any event, I should point out that stock market data--the most convincing evidence gathered to date in the attempt to determine whether or not mergers, on balance, create wealth--consistently indicate that mergers benefit shareholders. For example, one survey of the stock market evidence concludes that target company shareholders in successful tender offer acquisitions gain, on average, a premium of approximately 30 percent over the pre-offer market price, while the shareholders in the bidding firm experience increases in their share value of about 3 to 4 percent. 1/

Some accounts of recent mergers suggest that we are in the midst of an uncontrollable "merger mania." A look at the statistics on mergers helps to put the present situation in a more balanced perspective.

First, the number of acquisition transactions (measured most broadly to include divestitures and "going private" transactions) in 1985, according to W.T. Grimm & Co., was 3,001, only about 20-25% more than the relatively constant number of transactions in each of the ten prior years (1975-84). The largest number of transactions actually occurred in 1968: 6,107, or more than twice the 1985 level. In fact, in each of the seven years from 1967 to 1973 there were about as many or even more transactions than in 1985. Obviously, as measured by the number of transactions, we are closer to business as usual than to any so-called merger mania.

The number of transactions is only part of the story, of course. An important change that has occurred in recent years is in the dollar value of such transactions and, in particular, the number of very large companies that are being acquired or

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1/ Jensen & Ruback, The Market for Corporate Control: The Scientific Evidence 11 J. Fin. Econ. 5, 7 (1983).

are "going private." The first $1 billion transaction was in 1970, and between 1970 and 1978 there were only five such transactions. In contrast, there were 16 such deals (three of them over $5 billion) in 1984 and 22 in 1985. Thus, measured in annual dollar volume, after adjusting for inflation, merger and acquisition activity has only recently exceeded the peak reached in 1968, by about 40%. The market for corporate control is thus no longer a simple matter of large companies acquiring small ones. Some of the country's largest and most familiar companies are being acquired, or restructured, or taken private, sometimes in a hostile takeover or as a result of the threat of one. The professional managers of the Fortune 500 companies have discovered that the large size of the companies they manage is no longer an absolute barrier to a challenge to their control through a hostile takeover. These managers have to compete, like the managers of other firms, to retain shareholder confidence, and that's good for their companies and for the economy because it helps keep American firms competitive in an increasingly competitive world.

Moreover, the increased activity in the mergers and acquisitions market has not resulted in an increase in aggregate concentration in our economy. On the contrary, a review of the data reveals that no increase has occurred in the percentage of total assets or total employment accounted for by the 25, 100, and 200 largest firms in the U.S. economy. In fact, aggregate concentration appears to have declined a bit since 1970. Thus, our estimate of the share of assets represented by the 25 largest firms in 1970 fell from 17% in 1970 to less than 13% in 1984. Looking at the 25 largest firms each year, their share of total assets fell from 17% to about 14% over the same period. The asset share of the 100 largest nonfinancial corporations fell from 29.1% in 1970 to 26.6% in 1984, while the share of the 200 largest firms fell from 37.9% to 34.1%.

Similarly, aggregate concentration of the employment share of the largest firms has fallen. The share of the top 25 employers in 1970 was approximately 10%; in 1984 these firms had a share of just over 6%. The share of the 100 largest employers each year fell from 18.8% in 1970 to 15.1% in 1984. The share of the 200 largest firms fell from 24.5% to 20.5% over the same period. I should note that if the AT&T divestiture had not occurred, the 1984 percentages would be somewhat higher than they are, but the comparison across the last 15 years would yield the same conclusion: aggregate concentration is, if anything, declining.

The turnover among the largest firms in the economy is perhaps even more noteworthy. For example, our data indicate that of the 25 largest firms in 1970, ranked by assets, only 19 were still among the 25 largest in 1984. Another study concluded that for a firm in the top 100 in 1945, the chances were 50-50 that it would not be in the top 100 in 1975.

Thus, data describing aggregate concentration and turnover among the largest firms in the economy do not support those who see in the recent level of merger activity ominous portents of an increasingly concentrated corporate economy.

Of course, antitrust analysis does not focus on either aggregate concentration in the economy or on the absolute size of the parties to a merger, the features most often emphasized in press accounts but utterly irrelevant to antitrust analysis. Rather, the concern of antitrust is whether a merger likely will have an adverse effect on competition in any properly defined market. The Department continues to apply sound legal and economic principles--as outlined in our Merger Guidelines--in analyzing the likely competitive effects of proposed mergers. Among other things, our analysis takes into full account foreign competition, entry conditions, and any efficiencies that could not be realized by any other means than the merger under scrutiny. If our analysis leads us to conclude that a merger threatens adversely to affect a market's competitive performance, either by creating or expanding a single firm with significant market power or by facilitating collusion among the remaining firms, the Department is ready, able, and willing to block the proposed transaction. The analysis now performed by the Department and, increasingly, by the courts reflects the substantial advances in economic learning that have been made in recent years.

The purpose of S. 2160, the "Merger Modernization Act of 1986," is to facilitate the ongoing transition to rational merger analysis under section 7 by bringing the 70-year-old statutory language up to date. The uncertainty surrounding merger analysis in 1914, and even in 1950 when section 7 was last revised substantially, can be seen in the vague wording of section 7 itself, which prohibits mergers the effect of which "may be substantially to lessen competition, or to tend to create a monopoly." Up through the late 1960s, courts lacked a meaningful framework for merger analysis. They therefore relied primarily on crude measures of concentration in the affected markets to gauge the competitive effects of mergers, giving little, if any, consideration to other relevant factors. 2/

Efforts today to establish a modern and consistent merger standard are complicated by the fact that the current language of section 7 carries the baggage of decades of inconsistent and economically unsophisticated judicial merger analyses. The Supreme Court has construed the language of section 7 to mean that before a merger may be condemned, the government or a private plaintiff must prove at least a reasonable probability or reasonable likelihood that the merger would substantially

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2/ See, e.g., the Supreme Court's decisions in Brown Shoe Co. v. United States, 370 U.S. 294 (1962), and United States v. Von's Grocery Co., 384 U.S. 270 (1966). The accuracy of the market share estimates in Brown Shoe was called into question in Peterman, The Brown Shoe Case, 18 J. Law & Econ. 81 (1975).

lessen competition. 3/ Notwithstanding this construction, however, section 7 has been and continues to be applied by some courts in an overly restrictive manner that is patently inconsistent with proper merger enforcement policy. This creates great uncertainty for parties trying to plan transactions that will pass muster under section 7.

Unfortunately, refining and modernizing outdated merger standards and analysis through the issuance of enforcement guidelines and case-by-case adjudication is slow and can result in an inconsistent body of case law. In consequence, the confusion surrounding the existing language in section 7 is slowing the pace at which the modernization of merger analysis under the antitrust laws can proceed.

S. 2160 revises the language of section 7 to incorporate the advances in merger analysis that have been made during the last 20 years. As a result of this revision, we will have a new, state-of-the-art statutory foundation upon which future refinements and improvements can be built. S. 2160 will clarify the law and promote consistency in court decisions. It will enable us to lay to rest once and for all the outmoded economic and legal analysis of mergers that can be found in older court decisions.

3/ See, e.g., United States v. Marine Bancorporation, 418 U.S. 602, 622-23 (1974); United States v. Citizens & Southern National Bank, 422 U.S. 86, 122 (1975).

The Merger Modernization Act achieves its goal in three basic ways. First, the Act amends section 7 to state more precisely the degree of certainty regarding anticompetitive effects that is legally required to prohibit a merger. The Act requires that there be a "significant probability" that a merger will be competitively harmful before it will be prohibited, thus replacing the more ambiguous "may be" and "tend to" language currently in section 7. This new standard more accurately reflects Supreme Court case law and current enforcement policy interpreting section 7 by making it clear that the law is not intended to prohibit mergers based on the mere possibility, rather than the significant probability, that anticompetitive effects will follow.

Second, the Act makes clear that section 7 is directed against mergers that threaten to increase consumer prices. It does this by replacing the existing "lessen competition" or "create a monopoly" language with a more precisely defined market power standard, in keeping with modern economic analysis. Anticompetitive mergers are explicitly defined as those that "substantially increase the ability to exercise market power," and the ability to exercise market power is defined as "the ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time." The Act thus affirms that section 7 is intended to protect consumers by preserving competition, rather than to benefit particular competitors. It does so by focusing merger analysis on whether firms will have the ability to raise prices to consumers as a consequence of a merger. While this approach has been increasingly accepted by courts interpreting section 7, the new language is clearer and less likely to be misapplied.

Third, the Act establishes a sound framework for determining the likely effects of mergers by clearly directing courts to consider a nonexclusive list of six economic factors that bear on that analysis. It thus assures that no one factor will be determinative of a merger's legality, to the exclusion of other probative economic evidence.

Section 7 has always required and will continue to require that the anticompetitive effects of a merger or acquisition be evaluated "in any line of commerce . . . in any section of the country." Whether a proposed merger will give rise to an increased ability to exercise market power within clearly defined product and geographic markets is thus the central issue under section 7; it is only within the confines of meaningful economic markets that the competitive effects of a proposed merger can be accurately evaluated.

In order to define relevant markets, it is necessary to evaluate the probable future responses of domestic purchasers and of foreign and domestic producers to any attempt to exercise market power. The availability of close substitutes for the product in question and the ability of other firms to enter into or expand production are the major constraints on market power. Thus a market can be defined as a product or group of products and a geographic area such that a profit-maximizing firm that was the only seller of those products in the area would impose a significant and nontransitory price increase above prevailing or likely future levels. Relevant markets can only be determined in the context of specific mergers, but accuracy in their definition is crucial.

Once the relevant market (or markets) has been correctly defined, it is possible to evaluate the probable effect of a merger on the ability of one or more firms in the market profitably to maintain prices above competitive levels. The Act identifies six specific factors that courts should consider in assessing that effect. It also directs the courts to consider any other relevant evidence.

The first of the six factors is "the number and size distribution of firms and the effect of the acquisition thereon." Other things being equal, concentration affects the likelihood that one dominant firm, or two or more firms acting collectively, could exercise market power. The greater the percentage of the market supplied by a dominant firm, the easier it would be for that firm profitably to restrict output sufficiently to effect a price increase. Where collective action is needed to restrict output and raise prices, the costs of achieving and maintaining such action will be less, and the chances for success greater, the smaller the number of firms that must cooperate to do so. Of course, it is not the number of firms in the market alone that must be considered. The relative size of the firms in the market is also relevant to the likelihood that collusion would be successful. For this reason, a concentration measure such as the Herfindahl-Hirschman Index ("HHI"), which takes into account both the number and size distribution of firms in the market, is generally the starting point for merger analysis.

Concentration data is only the starting point, however. As the Supreme Court made clear in General Dynamics, 4/ it is also necessary to take account of factors indicating that concentration data may not accurately reflect future market positions, as well as other factors that bear on the likely future exercise of market power.

Thus, the second factor S. 2160 requires courts to consider is the "ease or difficulty of entry by foreign or domestic firms" into the market. If firms not presently in the market could profitably and readily enter in response to a price increase, it is less likely that firms presently in the market could profitably maintain prices above competitive levels for a significant period of time. 5/ Conversely, if such entry into

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4/ United States v. General Dynamics Corp., 415 U.S. 486 (1974).

5/ Entry conditions have figured prominently in several recent merger decisions, including United States v. Waste Management, Inc., 743 F.2d 976 (2d Cir. 1984), United States v. Calmar Inc., 612 F. Supp. 1298 (D.N.J. 1985), and Echlin Mfg. Co., 3 Trade Reg. Rep. (CCH) ¶ 22,268 (F.T.C. June 28, 1985).

the market is unlikely, significant market concentration more accurately reflects the risk of a price increase following a merger.

The third factor to be considered is "the ability of smaller firms in the market to increase production in response to an attempt to exercise market power." The effect of this factor is similar to ease of entry. An attempt by larger firms acting alone or in concert to exercise market power would be undercut if smaller firms in the market had the ability to increase their output significantly in response to a price increase. 6/

The fourth factor to be considered is "the nature of the product and terms of sale." Agreements among producers to raise prices should generally be easier to reach with respect to relatively undifferentiated products than with respect to products that are more complex, heterogenous, and subject to options. 7/ Also relevant is the degree of difference between the products and sellers considered to be in the market and the next-best substitutes. The larger the gap at the edge of the product and geographic markets, the more likely are effects that can be predicted on the basis of market concentration data.

6/ The importance of fringe firms in evaluating market power is discussed in Landes & Posner, Market Power in Antitrust Cases, 94 Harv. L. Rev. 937, 944-950 (1981).

7/ For a discussion of the relevance of product homogeneity or heterogeneity to an assessment of competitive conditions and the probability of collusion, see R. Posner, Antitrust Law 59-60 (1976), and F. Scherer, Industrial Market Structure and Economic Performance 200-205 (1980).

The fifth relevant factor is the "conduct of firms in the market." If the firms in the market have a history of violating the antitrust laws, and market characteristics basically have not changed, increasing the degree of concentration in the market will be of greater concern than it would be if the firms had no such history, since increased concentration resulting from a merger could further strengthen any existing potential for the exercise of market power. 8/

The sixth factor--"efficiencies deriving from the acquisition"--would be considered only in cases where the factors discussed above (or any others) indicate that allowing the merger would significantly increase the risk of market power being exercised, to the detriment of consumers. Merging firms should not otherwise have the burden of establishing an affirmative case for the existence of efficiencies. Where it is necessary to consider efficiencies, however, the courts should also consider whether those or similar efficiencies could be achieved by the firms without merging, and whether, in light of their nature and post-merger market circumstances, the claimed efficiencies will result in price benefits to consumers. Only real, resource-saving efficiencies should be considered; merely pecuniary gains to the merged firm, such as tax advantages, are not relevant.

8/ An industry's antitrust "record" is widely viewed as an important consideration in an examination of whether conditions in an industry are favorable to collusion. See R. Posner, Antitrust Law 61 (1976).

Efficiencies might derive from economies of scale, better integration of production facilities, plant specialization, lower transportation costs, and similar savings relating to specific manufacturing, servicing, or distribution operations of the merging firms. Any other real efficiencies, such as financial economies, also can be considered where it is demonstrated that they will be achievable.

Finally, the Act requires the consideration of "any other evidence indicating whether the acquisition will or will not substantially increase the ability, unilaterally or collectively, to exercise market power." This "catch-all" provision ensures that the courts will not ignore any significant economic evidence regarding the likely effects of a merger. This provision also builds into section 7 additional flexibility to take proper account of further advances in economic learning with respect to the effects of mergers and acquisitions in a market economy.

I would like to take this opportunity briefly to address some criticisms that have been leveled at the Merger Modernization Act. The Act is apparently seen by some as a proposal to allow mergers essentially "at will." As the discussion above indicates, this is emphatically not the purpose and certainly would not be the effect of our bill. We are suggesting three specific revisions to section 7, each of which would promote sound antitrust merger analysis and would continue to prevent anticompetitive transactions. In short, the revised section 7 will make it clear that merger law deals with probabilities, not mere possibilities, of harm to consumers, with market power as the consumer harm to be avoided, and with sound economic analysis as the key to a rational decision on the lawfulness or unlawfulness of any particular merger. Under the revised section 7, we will continue to preview mergers pursuant to the Hart-Scott-Rodino Act, and will continue to take enforcement action against anticompetitive mergers.

Mr. Chairman, this concludes my prepared statement. I would be happy to address any questions the Committee may have.

U.S. Department of Justice

Antitrust Division

Office of the Assistant Attorney General *Washington, D.C. 20530*

MAY [illegible]

Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

During my testimony before the Committee on April 9, 1986, concerning merger law reform, I promised to supply for the record suitable versions of two charts to which I was referring, describing decreasing ratios of total assets and total employment accounted for by the largest firms in the economy. Enclosed are tables containing the information set forth on those charts.

I also noted that the dollar volume of credit used to finance mergers and acquisitions was but a small percentage of total corporate sector debt, and promised to supply more accurate data for the record. According to the Economic Report of the President transmitted to the Congress in February 1985, during the first 7 months of 1984, a particularly active period for leveraged takeovers, loans for the purpose of completing large acquisitions amounted to $21.8 billion, or about 1.3 percent of commercial bank loans and investments outstanding during the same period (and a substantially smaller percentage of aggregate borrowing in the economy.)

Sincerely,

Douglas Ginsburg

Douglas H. Ginsburg
Assistant Attorney General

Enclosure

CHART I

Aggregate Concentration Ratio for Assets

Share of Largest 100 and 200 Non-Financial Corporations

	1970	1975	1978	1979	1980	1981	1982	1983	1984
Top 100	29.1	29.2	27.9	27.7	28.0	27.6	27.3	26.9	26.6
Top 200	37.9	37.7	36.0	35.6	35.9	35.4	35.0	34.4	34.1

Control by Largest Corporations

Percentage of Total Assets of Non-Financial Corporations Held By:

	1970	1975	1980	1982	1984
Top 25 Corporate Assets Holders of 1970	16.86%	17.03%	15.97%	15.26%	12.70%
Top 25 Corporate Asset Holders in Each Year	16.86%	17.23%	16.56%	15.89%	14.10%

CHART II

Aggregate Concentration for Employment

Percentage of Total Non-Farm Private Sector Employment

	1970	1975	1978	1979	1980	1981	1982	1983	1984
Top 100 Corporations	18.8	17.7	16.9	16.7	16.6	16.4	16.1	16.1	15.1
Top 200 Corporations	24.5	23.3	22.4	22.6	22.1	22.1	21.6	21.5	20.5

Control by Largest Corporations

Percentage of Total Non-Farm Private Sector Employees

	1970	1975	1980	1984
Controlled by the Top 25 Employers of 1970	10.18%	9.60%	8.09%	6.23%
Controlled by the Top 25 Employers Each Year	10.18%	9.88%	8.90%	7.43%

Mr. GINSBURG. Two useful ways of measuring aggregate concentration in the economy are to ask what percentage of total assets, or what percentage of total employment is attributable to the largest firms in the economy. Looking at these charts, we see answers to those questions, for the period from 1970 through 1984, with respect to both employment and assets, measured three different ways.

First, such concentration is measured by reference to the largest 200 firms in the country, then by reference to the largest 110 firms, and finally, the largest 25 firms.

As can be seen from the charts, there has been a continuous and noticeable decrease in concentration measured in this fashion over the entire relevant period.

The actual numbers involved, to take just one example, reflect a decline in the share held by the 25 largest firms, measured by assets, from 17 percent of the total to 13 percent over that period of time.

Perhaps as interesting in this regard is the fact that the turnover among the identity of the largest firms has been significant. Of the 25 firms that were the largest in 1970, only 19 appear in the 1984 list, and that is after taking account of any disappearance by reason of mergers. That is, six firms are not represented either as independent firms or as components in another firm, as of 1985.

That reflects the dynamic nature of the economy, and the competitiveness of our larger firms. These data certainly do not support the fears of those who see in the recent level of merger activity some ominous portent of an increasingly concentrated economy.

Now, of course, antitrust analysis does not focus attention either on aggregate concentration in the economy, nor on the absolute size of the firms involved. Rather, the concern of antitrust law with any particular merger is whether it will have an adverse effect on competition in any properly defined market.

The Department continues to apply sound legal and economic principles, as outlined in our merger guidelines, in analyzing the likely competitive effect of proposed mergers.

Among other things, our analysis takes into full account foreign competition, entry conditions, and any efficiencies that could not be realized by any means other than the merger.

Mr. Chairman, section 7 was last revised in 1950, and even then has not been substantially revisited since 1914. In its present form, we have a statute that is very vague in its wording. The central tenet of the statute is to prevent mergers the effect of which, and I quote, "may be substantially to lessen competition or to tend to create a monopoly."

Through the 1960's, I think it is fair to say that the courts administering this statute and reviewing the work of the enforcement agencies lacked any meaningful framework for antitrust analysis. At best, they relied on crude measures of concentration in the affected markets in order to gauge approximately the competitive effects of mergers, giving little, if any, consideration to all of the other relevant factors.

Finally, after many decades of experience, the Supreme Court did clarify that section 7 was not to be read in its most expansive interpretation to prohibit any merger that may have the prohibited effect; but rather to require at least a reasonable probability, or a reasonable likelihood that the merger in question would in fact lessen competition

Notwithstanding this construction of section 7, the statute continues to be applied by courts in an inconsistent and often overly restrictive manner. Senate bill 2160 would revise the language of section 7 to incorporate the advances in merger analysis that have been made during the last 20 years. This bill would clarify the law and promote consistency in court decisions.

Senator SPECTER. What is the essence, Mr. Ginsburg, concerning the change, if any, in the 1950 statute?

Mr. GINSBURG. The change being proposed now, Senator?

Senator SPECTER. Yes.

Mr. GINSBURG. Well, the essence of the proposal is captured in three aspects of the bill. First, it would clarify and make more precise the standard by which a merger's illegality would be determined. Second, it would clarify that the harm to be prevented in analyzing mergers is an increase in prices to consumers. That should be the focus of the entire analysis. And finally, it would provide courts with a nonexclusive list of six factors that should be considered, that would have to be considered, before a merger could be prohibited.

In sum, with those three changes, the bill would make it clear, first, that merger law is meant to deal with probabilities and not mere possibilities; second, that the probability of relevance here is that of a harm to consumers, as measured by market power; and third, that there is available a sound economic analysis for analyzing any particular merger.

Under revised section 7, the Department will continue to preview mergers, pursuant to the Hart-Scott-Rodino Act, and would be in a position to continue to take enforcement action against any mergers that are anticompetitive.

Thank you, Mr. Chairman. I would be happy to answer any further questions that you might have.

Senator SPECTER. Mr. Ginsburg, to what extent are these amendments a departure from existing case law?

Mr. GINSBURG. Well, Senator, any amendment would necessarily be something of a departure, because of the conflict and inconsistency in that case law. I would say that the intended effect of the bill is to codify the better decisions of the courts in the last decade or so, and to bring into statutory policy the enforcement policy of the Department over the last 5 years.

I would not, therefore, expect a change, any dramatic change, in the level of merger activity, or in the range of mergers that would go unchallenged by the Department.

Senator SPECTER. Have those three factors been addressed by decisions of the Supreme Court of the United States?

Mr. GINSBURG. The first of them has been addressed in a general fashion, in that the Court has guided the lower courts by directing them to look not for the mere possibility of a harm, but for an actual probability that will result.

Senator SPECTER. So is there any need for statutory changes to point 1?

Mr. GINSBURG. On point 1, I think it would be quite useful for the Congress to bring the statute into alignment with that thinking, and to do so in its own considered language.

Senator SPECTER. Are you suggesting a change from what the Supreme Court has defined the law to be by the language proposed in this bill?

Mr. GINSBURG. Well, again, if we go beyond the very first criterion, there will necessarily be some change in that there is more detail provided in the bill to guide the courts in their analyses than the Supreme Court has heretofore provided.

The process of a common law elaboration and the issuance of enforcement guidelines to bring the law into consistency with modern economic thought is a slow, imperfect, and uneven process. I think it would be highly beneficial for the Congress to bring the statute entirely up to date to reflect modern thinking.

Senator SPECTER. Mr. Chairman, if I might proceed for a few moments?

The CHAIRMAN. Yes, you may.

Senator SPECTER. How about the other two factors, Mr. Ginsburg? Have they been addressed in decisions by the U.S. Supreme Court?

Mr. GINSBURG. Well, the focus of the statute specifically and exclusively on the prohibition of market power, defined as the ability to raise prices to consumers, I think has been reflected only intermittently in Supreme Court decisions.

We have had—although fortunately not in recent years again—at least two substantial periods in the Court's history when this statute was interpreted to protect competitors, not consumers but competitors, from the effects of vigorous competition.

Senator SPECTER. Was that not with the view point ultimately of protecting consumers by maintaining the competition?

Mr. GINSBURG. No, Senator, with respect. The decisions were anticompetitive in their effect, and harmful to consumers. They have been overruled in the court of history, but not in the Supreme Court.

Senator SPECTER. How about the third item where you have the six standards? Has that been embodied in U.S. Supreme Court decisions?

Mr. GINSBURG. No, Senator. The enumeration of the six factors is taken from the current enforcement guidelines of the Department of Justice.

Some of these factors have appeared as important, indeed outcome-determining, factors in recent decisions of the lower courts. Perhaps one or two of them are reflected in the Supreme Court's thinking in *General Dynamics*.

Senator SPECTER. When did the Department of Justice promulgate those six factors?

Mr. GINSBURG. Those six factors all appear in the 1982 guidelines, and are also present in the revised 1984 guidelines.

Senator SPECTER. Mr. Ginsburg, under the proposed statute, would there be more or fewer mergers?

Mr. GINSBURG. I would not expect there to be any noticeable change in the number of mergers, comparing current enforcement policy and the policy and law under the codification we have proposed.

Senator SPECTER. So no effect on the number of mergers.

How about on the practical application of the law, given the Department of Justice's functions, and already having incorporated these standards in your practices? Would you anticipate—or you have already really said you don't anticipate any significant change in the application or enforcement of the antitrust law.

Mr. GINSBURG. I would, however, anticipate, Senator, that a significant degree of certainty would be provided to parties trying to plan transactions that is not possible now, because the Department of Justice does not have exclusive authority to initiate section 7 cases. There are private cases brought to enjoin mergers.

Senator SPECTER. Does the statute change that?

Mr. GINSBURG. No, sir, it would not.

Second, the courts have applied their own analyses in an inconsistent fashion that I think would be minimized by Congress' provision of this six-factor checklist.

Senator SPECTER. And also, if there is a statute, something could not happen in 1989 depending on what happens in 1988, unless the Congress acted?

Mr. GINSBURG. Well, it is certainly true that enforcement policy will continue to evolve. I would expect that there would be changes from one administration to the next; but I would not expect that this statute, which really imposes an economically rational analytic framework, would be unduly constraining on any of my successors in the Department of Justice.

Senator SPECTER. Thank you, Mr. Ginsburg. Thank you, Mr. Chairman.

The CHAIRMAN. Now, to follow up some of the questions asked by Senator Specter, Mr. Ginsburg, while this bill proposes to change the language of the test for mergers, would you say that the new language reflects a prevailing standard being applied by the Supreme Court and lower courts under the current language of the Clayton Act?

Mr. GINSBURG. Senator, the Supreme Court has only a very occasional opportunity to interpret section 7. A dozen years have elapsed since we really had any insight into the Court's thinking, although it is clear that the Court is taking an increasingly economic view of all of antitrust law.

If we look at the lower courts, I think it is quite fair to say that they are inconsistent in their application of section 7, and that this statute would eliminate the inconsistency by codifying the best of those decisions.

The CHAIRMAN. Now, could you elaborate on the meaning of the phrase "ability to exercise market power." and could you explain why this is the central concern of merger policy?

Mr. GINSBURG. Yes, sir. We read the Clayton Act as having been enacted for the protection and benefit of consumers. The consumers' stake in a merger is whether the resulting firm will have the power to raise prices that are charged to consumers. If the firm will not have that power as a result of the merger, then there is no antitrust reason to oppose its going forward.

We think that the central purpose and focus of the statute should be clarified, and the statute returned squarely to its historic purpose of protecting consumers.

The CHAIRMAN. Mr. Ginsburg, there is language in the 1984 merger guidelines that explains how the Justice Department identifies relevant markets in which mergers are analyzed. Would anything in this bill affect the way the markets are defined?

Mr. GINSBURG. The bill would not alter the way in which the Department or the courts properly define relevant markets.

The CHAIRMAN. Speak a little louder.

Mr. GINSBURG. I'm sorry. The bill would not change either the Department's or the courts' approach to the definition of relevant markets.

The CHAIRMAN. Mr. Ginsburg, both efficiencies and foreign competition are mentioned as factors to be considered in analyzing mergers. Could you explain how efficiencies and foreign competition are measured and taken into account in current merger analysis?

Mr. GINSBURG. Yes, sir; we regard foreign competition and domestic competition as being equally relevant in trying to project the effect that a merger will have on market power.

Foreign competitors are an everpresent factor in most American product markets, as Secretary Baldrige elaborated earlier. And there is no reason to discount their force in the market as a competitive check on firms. Under the statutory proposal, that attitude reflected in our enforcement guidelines would be codified.

With respect to the relevance of efficiencies, I think it is hard to disregard the fact that mergers that produce significant efficiencies are likely to result in reduced prices to consumers. If the merger will have the effect of realizing significant efficiencies and if the market remains reasonably competitive, we can expect that to redound to the benefit of consumers.

The CHAIRMAN. Thank you. The distinguished Senator from Alabama.

Senator HEFLIN. The language of S. 2160 basically strikes out the words "to lessen competition or tend to create a monopoly," and substitutes in lieu thereof "increase the ability to exercise market power." This seems to be the main thrust throughout.

Then, in the, definition section of the bill, the ability to exercise market power is defined as the "ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time."

What is the significance of "above competitive levels"? Why the use of the word "above" in maintaining prices above competitive levels, rather than at competitive levels?

Mr. GINSBURG. Senator, the way the statute would operate, the merger would be unlawful if it had the effect of facilitating the merged firm's, or any firm's, ability to maintain prices above competitive levels. That is to say, if it would increase their market power.

If the postmerger market is still going to be a very competitive one, then the firm will not be able to maintain prices above competitive levels, and the merger should not be prevented by section 7.

Senator HEFLIN. Now, in the definition section, on the ability to exercise market power, there is set forth a number of economic factors relevant to the effect of the acquisition in the affected markets. The bill then lists those factors. The last factor, says "any other evidence indicating whether the acquisition will or will not substantially increase the ability, unilaterally or collectively to exercise market power."

What type of evidence do you anticipate would fall within that economic factor?

Mr. GINSBURG. Senator, that factor is intended to allow in evidence that may be relevant in a particular case, but would not be found in the general run of cases. To take an example from the Supreme Court's decision, in *General Dynamics,* the Court there observed that the capacity that one of the merged firms brought to the merger was really not indicative of its market power because it had entered into contracts that tied up that capacity to supply particular customers for a long period of time. So that the capacity would not be available to other customers.

That was relevant economic evidence that bore on the merged firm's ability to exercise market power, but it was quite peculiar to that case. It would have been a mistake to have omitted that, to have excluded that evidence, because it was relevant. But it was certainly idiosyncratic.

Senator HEFLIN. Well, the words are "unilaterally or collectively which will or will not substantially increase the ability to exercise market power." Reading that, you wonder whether or not that really establishes any criteria, or whether that opens a flood gate. That raises some questions of what it could be.

Mr. GINSBURG. Well, Senator, the language has, of course, acquired a good deal of meaning, and I think is well understood by the antitrust bar through the informal process of enforcement policy over the last 5 years, but is not necessarily yet clarified in court decisions. So I sympathize with your plight in reading this language.

The intent, if I can advert to our intent in explaining the statute, is to ask two basic questions about every merger: First is it probable that the merger will result in the merged firm being able to increase prices to consumers, even though it has not experienced any increase in cost? Now, at the extreme, that is called monopoly power. But in less extreme situations, it is referred to as market power.

Second, if the firm is not going to be in that position, we still go on to ask whether the merger is likely to create a market condition in which firms are going to collude or conspire to raise prices to consumers. That occurs occasionally as a problem in a proposed merger, where, for instance, a price-cutter, a discounter, a firm that has been the highly competitive element in the market, is being acquired by the dominant firm, or the largest firm in the market. One needs to worry that the elimination of that particular firm will reduce the competitive vigor of the market.

Those are the two basic considerations: unilateral exercise of market power, and increased probability of collusion.

Senator HEFLIN. Maybe that language could be clarified. It seems to be extremely broad allowing any interpretation, which would nullify some of the guidelines or factors. That is all.

Mr. GINSBURG. Senator, if, I may make one suggestion, since the intention of the bill in enumerating these factors is to list the principles underlying the current merger guidelines, I think that those merger guidelines themselves, which are 30 pages long and not just six principles, are the best source of further guidance to the public about the meaning of the statute if it is enacted.

Senator HEFLIN. If somebody will review those—sometimes, they do not. That is all. I do not have any further questions.

The CHAIRMAN. The distinguished Senator from Illinois.

Senator SIMON. Thank you, Mr. Chairman. I thank our witnesses, Mr. Secretary, for your efforts to improve world trade. I laud you. I appreciate what you are doing.

I have to say in this area, I could not disagree more. I think you summarized the situation very well in the third page of your testimony, where you say, "I would like the message to business to be clear: consider a merger. Unless there is a significant probability that your business will have—" and significant probability is the language here, and it is the language that you insert in the statute—"significant probability that your business will have the power, alone or with other firms, to overcharge consumers, it will be lawful."

To use the phrase of my distinguished colleague from Alabama, that opens the floodgate. I do not think there is any question. For the free enterprise system to work successfully we have to increase competition, not lessen it. We already have far too many mergers, far too many acquisitions. It is more profitable to explore for oil on the floor of the New York Stock Exchange than it is in the fields of Illinois, or Indiana, or Ohio right now.

I am willing to give tax breaks to, say, United States Steel to expand. But when United States Steel buys Marathon Oil, it doesn't create one new job, it doesn't dig one new oil well, it doesn't do anything for the country. This legislation would only accelerate a trend that is already here in this administration.

In Monday's Washington Post there is a very interesting article, "Death of a Law Firm," concerning the Bergson-Borkman law firm. The main reason for its demise is that antitrust work plummeted under the Reagan administration.

Let me read a little further on in this article.

"Then the Reagan administration took over and all but stopped bringing the antitrust cases that were the firm's bread and butter. They reshaped antitrust policy in this country," Margolius said. "We lost cases in the Supreme Court in the 1960's that never would have been brought by the Department now. The revolution in antitrust laws had not been foreseen," Adler said: "When other Republican administrations came, there had probably been an increase in antitrust."

It just seems to me the thrust is exactly in the wrong direction. Now obviously, you disagree with me, Mr. Secretary, but I would be interested in your response.

Mr. BALDRIGE. Senator, as you know, I respect and admire your work. But what you just said, I disagree with 100 percent.

I will start with your concern for the death of a law firm. I will tell you what. We have got one lawyer for every 350 people in the United States. That is about one-twentieth—I mean that is twenty times more per capita, or more than that, 50 times more than a lot of our competitors do. And I have sympathy for farmers. I have got sympathy for people in the oil patch. I have got sympathy for steel workers and so forth, textile workers. I find it really difficult, very difficult, to muster up much sympathy for lawyers. I think they ought to share in this winnowing-down process that this country is going through, because our society is far too litigious and it is not helping the consumers.

Now, as far as your talking about opening the flood gates, Mr. Ginsburg presented testimony which showed the aggregate concentration on those charts of what has happened since 1970. And particularly, if you will notice those curves in the last 2 years, it is simply not true that we are in any kind of a mergermania.

We had more mergers, by double, in 1968 than we had last year. In every year from 1968 through 1975, we had about the same number of mergers as we are having this year.

What we are seeing is an attempt for U.S. industry to restructure as part of a worldwide competitive effort, where you no longer, sir, can look at the United States as one market and the U.S. companies as the only people serving that market. You have to look at this as a worldwide market where our companies have to be able to export as well as just fight off competition from importers.

And the competitors are not just the U.S. companies; they are companies around the world. So the effort in this bill is to look at this from a global perspective, because that is where the fighting in the trenches is going on—not just the number of U.S. companies involved in the U.S. market.

Senator **Simon**. If I may respond, Mr. Secretary, I could not agree with you more on the fact that we have way too much litigation. And, as a nonlawyer on this Judiciary Committee, the numbers are astounding. But this is not the subject that we are talking about. We have moved from 270,000 lawyers in 1970, to 640,000 lawyers today, while Japan has 11,000, West Germany, 47,000, and I could go on.

But when all of a sudden lawyers, law firms are expanding and lawyers are keeping busier and busier, but antitrust lawyers do not find anything to do because this administration is not doing anything in the antitrust field, that I think sends a message.

The reality in the world trade field is that our problems are the dollar, our problems are our culture where we have not learned to speak other languages, our problems are the fact that we have not been tough enough and we have not paid enough attention to trade.

Mergers are just a very, very tiny part. They will not solve the inability of our companies to work together. We can solve that without passing something like S. 2160. Teddy Roosevelt would be turning over in his grave if he saw a Republican administration introducing legislation like this.

Mr. **Baldrige**. I do not know how to answer that question, or the opinion you gave, Senator, about antitrust being only a tiny little part of the problem. I have said in my testimony that we do not claim, and have never claimed, that antitrust is the largest factor in our trade balance. Some of our opponents have tried to say that, to set up a straw man to shoot down. But I will tell you, we have never claimed that.

It is a part of the overall mosaic of competitiveness. And as you rightfully point out, the strength of the dollar and some other competitive factors—I can name four or five that are more important than antitrust reform.

But in the situation we are in in world competition, we do not, sir, want to overlook anything we can do to help our overall competitiveness.

And I would like to give you a quick example, if I may, that I gave to the House, on just how that happens. I have permission from the company that was involved.

In the very large truck market, the largest kinds of trucks—not off-the-road, but they are highway trucks—there are about seven or eight companies: Paccar, that makes PeterBilt trucks; White; International Harvester; GM; Ford; Freight Liner; and Mack.

Now, for one reason or another, Freight Liner wanted to sell, and Paccar, the people that make PeterBilt trucks, wanted to buy them. They both had, oh, 15 to 18 percent of the market.

The lawyers at Paccar said, "No, under Clayton seven we would be worried about how that would come out. We could not guarantee it one way or another, but we are uncertain." So they advised the management not to do it. The management did not do it. And Freight Liner was sold then to Daimler-Benz. Now Daimler-Benz happens to be the largest large truck manufacturer in the world. And that gave them a market, a ready-made market in the United States, with an existing distribution system, manufacturing, and so forth.

All right. The second company that came up for sale was Mack Truck. Signal Cos. wanted to sell them for reasons of their own. Paccar went through the same process, the CEO wanted to buy them. The lawyers told them the same thing. He said no. Over comes Renault.

Renault is the second-largest large truck manufacturer in the world. So they bought Mack Truck. And they now have the distribution facilities, and so forth, to sell in the United States.

The third time it happened was with White. Volvo bought White.

Now you can't tell me, sir, that the intent of our antitrust laws is to let the largest foreign firms in the world come over here and begin to take over our markets. And it doesn't just hurt our trucking companies, it hurts their suppliers. Cummins Engines was making all the diesel engines for those three or four companies; earned that right the hard way. Half of that has been taken away now and sent abroad. That is not what our antitrust laws are set up to do. And that is not protecting the consumer, to have the largest companies abroad come in here and become the largest companies here.

Senator SIMON. I do not mean any disrespect to the anecdotal evidence you just gave, because we all use that. But I would be interested in substantial evidence that you can provide that this is going to move in the direction that you are talking about, and that there are not easier ways to deal with the world trade problem than to decimate our antitrust laws. I think that that is what this bill does.

Under the bill everyone is losing: the free enterprise system, consumers, everyone.

But I would be interested in that substantial evidence.

Mr. BALDRIGE. I would be glad to.

Senator SIMON. Thank you very much.

Mr. BALDRIGE. Thank you, sir.

Senator HEFLIN. Senator Thurmond asked me to preside until he returns.

Senator McConnell, do you have some questions?

Senator MCCONNELL. No; I do not, Senator Heflin, other than to say that I am sympathetic, Mr. Secretary, with your proposals. I am sorry I was not here earlier when you were testifying, but I find your case a good deal more convincing than I gather my colleague from Illinois does.

Mr. BALDRIGE. Thank you.

Senator MCCONNELL. I really do not have any questions.

Mr. GINSBURG. Senator McConnell, Senator Simon said some things about the administration's enforcement of the antitrust laws, and I would ask for a moment to comment on his remarks.

I think, Senator Simon, that more sophistication than is to be found in the pages of the Washington Post is sometimes necessary in order to understand a complex phenomenon. The fact is that this administration has had the most vigorous antitrust enforcement program in the history of the Sherman Act.

We have obtained 750-odd criminal antitrust convictions in the last 5 years under this administration. We have collected about $108 million in fines. Approximately 180 individuals have been sent to jail for a total period of about 23,000 days.

This is absolutely unprecedented. What has happened to the antitrust bar, which is a matter of no moment to the public interest, is that the antitrust work in defending cases against the Government has been distributed relatively evenly around the country, because these criminal cases are tried in the judicial district where they are found, unlike big merger cases which can be brought anywhere that the firms operate.

So there is now a criminal antitrust practice in cities like Minneapolis and Milwaukee and Kansas City that there was not a few years ago.

Turning, however, to the merger area specifically—that is the area for which firms such as the one referenced in the article found themselves less in demand because their clients who were not being sued as often—the statistics, the numbers, the facts simply do not bear out that simple story.

In this administration, we have brought suits against 29 mergers, which is on average a little bit down from the prior administration's annual enforcement numbers, and have caused another 16 mergers to be either abandoned or altered in response to our objections.

The reason that we have fewer litigated cases, even in the face of a larger number of merger transactions than was the case in the previous administration, is really quite simple: We issued guidelines in 1982 that make it quite clear, as clear as we can in writing, to counsel and to firms, what will and will not pass muster.

So we see transactions being proposed that have been thought out in response to those guidelines and shaped so as to avoid our initiating a lawsuit. That is a success story.

If we had no litigation whatever, it might be a complete success story, because we would have actually clarified the policy to the point that counsel could always anticipate it. I do not know why one would want more lawsuits and more litigation as a measure of a successful enforcement program That is a very simplistic way of going about it, if I may say so.

Senator **Simon**. Mr. Ginsburg you said that "you have the most vigorous antitrust administration," in history on antitrust laws. I have to tell you that that is not the impression that my colleagues and I have of this administration.

Senator **Metzenbaum**. Nor is it factual.

Senator **Simon**. And I will yield to my colleague in just a moment on that.

Let us just assume that you are a real zealot for enforcement of antitrust laws—and I hope you are—where did this idea come for this massive weakening of the antitrust laws? Did that come from your office? Did that come from the Attorney General? Did that come from the admininistration? Where did this come from?

Mr. **Ginsburg**. It comes from the advances in economic thinking developed over the last 15 or 20 years in the law schools and the economics departments of the country.

Senator **Simon**. Well, that kind of advancement, I will tell you, we do not need, if we want to thrive as a country.

Thank you, Mr. Chairman.

Senator **Heflin**. Senator Metzenbaum?

Senator **Metzenbaum**. I am sorry that I am late. I was on the floor and in another committee. But I ask unanimous consent, Mr. Chairman, that my opening statement may be included in the record.

Senator **Heflin**. With no objection, it will be so ordered.

Senator **Metzenbaum**. Now, Mr. Ginsburg, Mr. Baldrige, let us not kid ourselves about the facts concerning antitrust enforcement in this administration. It is really not the basic issue as to why this is bad legislation. But I do not think we ought to confuse the record, nor anybody in the American public, as to what this administration has done and has not done.

We all know that, under Mr. Baxter's leadership, that he did not believe in the laws, he made it very clear he did not believe in the law. And I remember when he appeared before me, I asked him how he could be a part of an administration that believed in law and order, and refuse to enforce the law.

Now, Mr. Ginsburg talks about the fact that so many cases have been brought, and most effective and most active. Well, you know that that is only telling half the story. Because those cases are a group of old cases going back to the 1970's, having to do with highway construction bidding contracts. And you had some great victories against some very small individual operators. But we are talking about mergers.

And the merger cases are down by a half, that is, those cases being brought by the Department.

Now, with respect to the level of merger activity, which I think is the bottom line of the whole issue, in 1983 the total number of mergers was 2,533, up 8 percent from 1982. That was the highest annual count since 1974.

The total dollar value paid for all transactions in 1983 was $73 billion, up 36 percent from $53 billion in 1982. The 1983 total was just short of the all-time record of $83 billion in 1981. Deals of $100 million or larger have risen steadily from 94 in 1980, to 113 in 1981, 116 in 1982, 137 in 1983, 200 in 1984, and 268 in 1985.

The extraordinarily high level of merger activity continued in 1984. There were 2,543 acquisitions in 1984, even higher than the 1983 level. In addition, the number of acquisitions of over $100 million in value was up 47 percent from the 1983 level.

The total for 1985 was 3,001, which was again a very substantial increase over the 1984 figure of 2,543. The largest 16 mergers in the Nation's history have occurred during the permissive climate that has existed since this administration took office.

In 1984, the Gulf-SoCal merger, $13.2 billion. In 1984, the Getty-Texaco merger, $10.1 billion. And then you can go on and on, one after the other, with the large mergers that have occurred.

And you read in the news magazines that come out weekly, you read in the Wall Street Journal, that there is an understanding in the business community that this administration has taken a more receptive attitude to big mergers, and, to use their quote, "bigness is not bad."

I would agree that bigness is not bad, but oftentimes with bigness comes domination of the market and the lack of competition, and the loss of protection for the consumers.

Mr. Baldrige, with respect to your legislation, which you and I have discussed previously—and I enjoyed having that discussion with you—I think that I reflect the view of many of us on this committee that the problem in connection with foreign trade, foreign economic involvement in our own Nation, is not a matter of antitrust law, it is a matter of American companies failing to do that which they should do on a competitive basis. And there is no better example of that than the report that we got within the last week that the General Motors Corp. is going to increase the prices of its cars while its lots and its factories are stocked with automobiles. And they still have the audacity to raise their prices. That is the reason the Japanese and the Belgians and the Germans, and all the others, and the Koreans, can bring their cars into this country—yes, and the Yugoslavians—and sell their cars. Because there has been an indifference on the part of the American auto industry.

I remember when the steel industry came to us and begged us for some help, and we gave them target pricing. The great steel industry, the great geniuses that run those companies, what did they do? Immediately, they raise their prices 6 percent, instead of going out and trying to get a greater share of the market.

So I would say to you that the indifference of the American industry, and the lack of competitiveness, and the failure to aggressively compete against foreign companies has much to do with the problem that we are experiencing as far as our balance of trade is concerned, and not the antitrust laws.

I have also said to you that, if there are specific instances in which there needs to be taken into consideration in connection with a merger the matter of foreign competition, the legislation that I have introduced would make that possible. But a broad-sweep approach to this issue does not make sense; it is illogical. And my opinion is, the U.S. Congress is not going to pass it.

But with respect to the fact that it is too complicated and people cannot understand the laws, as I understand you have stated, Mr. Ginsburg, they have been understanding them pretty well for a number of years. You talk about what is happening on the college campuses and what has to be done, maybe that is happening at the University of Chicago, but I think the other campuses of the country full well understand what the antitrust laws are, what they mean, what they have contributed to the American economy and the strength of the American economy, and I do not believe that we in Congress are prepared to change the laws with a broad-brush approach that is being suggested by this administration.

And I am prepared to say that any effort to do so on that basis will be resisted in the strongest possible way by those of us in Congress I think that the Congress has other matters on their agenda that are more important than that.

Mr. BALDRIGE. May I——

The CHAIRMAN. You may respond, Mr. Secretary.

Mr. BALDRIGE. Yes. Now that I see that Senator Metzenbaum has an open mind on this, I would like to——

Senator METZENBAUM. As I told you when we met——

Mr. BALDRIGE. I know.

Senator METZENBAUM. There is some room for compromise.

Mr. BALDRIGE. I would like to make some points, if I may, Senator.

You began by indicating that we were in kind of a mergermania situation now, an increasing number of mergers. The fact is that there were close to 3,000 mergers last year. That was up some over the year before, probably 20 percent, 25 percent. But in almost every year between 1968 and 1973, there were that many mergers. And in 1968, there were twice as many mergers. So I do not think we are seeing a change over a long period of time that really means much.

And as far as your point of companies getting larger and larger, where we have all of a sudden a very—you know, fewer companies, and they are all getting huge——

Senator METZENBAUM. Mr. Secretary, I do not want to interrupt you, but is it not the fact that between 1968 and 1973 you had that short period where mergers were occurring because they were playing with the price earnings yield. And if a company had a 25 PE ratio and another company had a 12 PE ratio, then they could make the merger, because the net bottom line was that the company that was the acquirer was able to make it appear that its earnings were up, and therefore there were many companies buying, buying, buying. They bought just on that basis without any particular relevancy as to the economic factors other than the stock market.

Mr. **Baldrige**. Well, there is no question some of that happened, Senator. But it was not just in 1968. That went on over a period of time.

But your point about industry just getting larger, businesses getting larger, Mr. Ginsburg's charts show the aggregate concentration both in employment and in assets. And they clearly show that concentration is getting smaller, and not larger. Whether you take the 25 largest firms, the top 100, or the top 200. It has gone down in the last few years, not up.

Third, I would like to point out, sir, that nobody is in love with bigness, but the world is getting bigger. It is a much different world than it was in 1950. And if you took the 30 largest industrial companies, strictly in industry, in the world in 1960, 28 out of the 30 were U.S. firms. In 1985, only 19 instead of 28; 19 were foreign firms, and 11 were U.S. firms.

So the number of U.S. firms in the largest 30 industrials around the world has gone from almost 93 percent of the total down to 30 or 31 percent.

Now I am not being for or against bigness. I am just saying the global market is going that way. And for us to sit here and say, "Well, we do not want our companies to get any bigger; we think it is bad," I wish the people that said that would go over and tell that to Siemens in Germany, and Mitsubishi in Japan, and Unilever in the United Kingdom, and some of the other companies that our people have to compete with.

There is a reason for that size. And it is not always a smart thing to do. But the market place takes care of that. But the ones that exist and last, do so because there is a reason for it.

And for us to deny our companies that privilege because people do not like bigness seems to me to be the height of folly.

Then you also had some kind words to say about General Motors and their latest price increase, and what has happened in the steel industry. I am no apologist for either one of those, Senator. But let me say, it is not really correct to call GM's price raise of 2.7 percent, or whatever it was, the actual transaction price. I do not know what they are doing. They may be raising the list price 2.7 percent so that they can deeper discount as a marketing tool when they come in. We will have to wait and see what the transaction price shows.

But if they have made a mistake, there is no way in the world that they will not pay for that mistake in this country. They do not have the market power to just raise prices and get away with it, unless people think their product is better. There is too much competition. And we will have to see how that comes out in the wash.

Senator **Metzenbaum**. But more Americans now buy foreign cars just because of that publicity. Even their own dealers have protested publicly. It is a terrible problem.

Mr. **Baldrige**. Well, we will have to see how it comes out. But I am not going to put myself in the driver's seat on what should be done there until I see what they actually do do

And as far as—well, I would not put myself in the driver's seat anyway; I am not in that business—but as far as steel goes, we had unfair trade practices against U.S. steel. We clearly saw subsidies, subsidized steel coming in from 17, 18 different countries around.

Yes, we did put in VRA's, the Presidential program. And yes, we did hear a lot of estimates that that would drive the price of steel up by 10 percent and cost the consumers more.

Well, Senator, since the VRA program started 18 months ago, until right now when the effect has been felt in the fourth quarter, it is working. Imports have gone from 28 percent down to 22 percent. The transactional price of all steel products is down by 4.7 percent, not up by 10 percent.

Steel is being sold more cheaply now in this country, overall steel, than it was 18 months ago. And so I fail to recognize where the steel companies have taken, or have been able to take any undue advantage of that.

Thank you, Mr. Chairman.

Senator SIMON. Mr. Chairman?

The CHAIRMAN. Yes, Senator Simon.

Senator SIMON. Could I ask one final question on this? First of all, on the 1968 figures you mentioned, and the 1985 figures, I would be interested in the total value of those mergers you were talking about.

Mr. BALDRIGE. Yes.

Senator SIMON. My guess is that it is going to be quite a contrast.

But if I may just ask both of you, while we are on this whole subject, are you at all concerned that we have companies just gobbling up other companies instead of using their capital for research, for expanding productivity, for creating new jobs in this country. That, it seems to me, we ought to be on a white horse and a charger, doing something about.

Instead, I come across a bill like this that moves just in the opposite direction.

Mr. BALDRIGE. Senator, the reason that there have been so many acquisitions since 1960, really, is that, for a good many reasons—part of it, the fault of the U.S. Government—the price earnings ratios of companies have been much lower than what it took to build new plants and new facilities. So it was literally cheaper, if you were running a company, for you to buy out another company, because the PE ratio was so low, than it would be for you to go out and build it yourself.

There is a long overdue correction that is occurring now The average PE ratio not too long ago on the New York Stock Exchange was about 8 or 9 or 10. Now, it has gotten up to almost 18. That is going to make a lot of difference in the number of acquisitions that you see, because it is now getting up to kind of the market value of what it would cost to replace it.

I think that is the major point I would make, sir. I do worry about our research and development. I do worry about the amount of funds were are spending in that area. That gets into a whole other area.

But when you mention the United States Steel-Marathon—or using their money to buy Marathon Oil, I could also point out that United States Steel in the last 7 or 8 years has put far, far more into their steel mills than they have taken out in depreciation plus any retained profits. And I believe that Marathon they either did with stock or with long-term debt. But they have clearly put more in their steel mills by far than they have got now in depreciation and profits.

Senator SIMON. I will use the United States Steel example again. They spent $6.5 billion to acquire Marathon Oil, borrowed $5.9 billion, which soaks up the credit market. It does nothing for United States Steel otherwise, or our capacity to produce steel or oil, or anything else. It just seems to me there ought to be greater concern on the part of this administration for the ultimate results of mergers and acquisitions.

Mr. BALDRIGE. You know, the reason for the oil companies becoming so popular as a merger partner in the last few years has been that the price of oil in the ground, the reserves were priced at such a favorable price; they were much cheaper to buy reserves in the ground for a company than it was to drill new wells for themselves.

I do not know how you fix that up, until the market adjusts itself. I do not know what you could do by legislative fiat to prevent that kind of thing from happening. But people were buying reserves in the ground more cheaply than they could drill for it.

I wish I knew the answer to that, but I do not.

Mr. GINSBURG. Senator, the inflation-adjusted dollar volume of merger and acquisition transactions in 1985 was 40 percent higher than it was in 1968, in answer to your specific question.

Much of the large dollar volume reflected in the transactions of recent years have been concentrated in a few industries. Petroleum, in particular, paper and forest products, financial institutions, food products, and tobacco would account for a very substantial portion of the total.

Each of those industries has undergone very substantial changes in recent years that have affected the value of their assets, similar to the situation the Secretary was describing regarding changes in the value of reserves in the oil industry.

The changes have come from world market factor price changes, as in the case of petroleum and of paper, from deregulation, as in the case of the financial institutions, from declining absolute markets, as in the case of tobacco, or from steady growth, as in the case of retail food products.

Managements that have been slow to realize the effects of those changes on their businesses have found themselves in difficulties, and either the subject of unwanted takeover offers or in need of stronger partners in their management arrangement. It is really quite startling when one sees how much of this activity is concentrated in particular industries.

The fact that the dollars are large is really not of any moment. It is not illegal for a transaction to be large, if it does not adversely affect competition. Nor does it divert money from more appropriate or more productive uses, as I thought I heard implied.

When a firm purchases another in a merger transaction, if it does use cash, that money becomes the property of the investors in the acquired company. Those investors are overwhelmingly institutions, pension funds, and so on, primarily fiduciaries investing the money of others. That money does not disappear. It does not go into the mattress of the pension fund manager. It is reinvested in other opportunities that are identified as the most appropriate by those fund managers.

That process of reallocation of resources is the lifeblood of a healthy economy. It is not a sign of something wrong, something afoot in the markets.

Senator **Simon**. But when you increase demand for money, you also increase the price of money. When you increase the price of money, you send the dollar up too high. That is one of the reasons for a lot of our problems. We have been in a vicious circle—and I do not want to extend this, Mr. Chairman, because I know we have other witnesses.

I would like to see some people in this administration every so often standing up and saying, "hold on, let us be careful about where we are going." I am not hearing that voice.

Mr. **Ginsburg**. Senator, if I may, the dollar volume of the credit used to finance mergers and acquisitions is a very small percentage. And I will supply you with the number, if I may, for the record. It is a very small percentage of the total credit taken by the corporate sector in this country. It is something like 2 or 3 percent.

The **Chairman**. Does that complete these witnesses now? Are you through with these witnesses, Senator?

Senator **Simon**. Yes, I am. Thank you.

The **Chairman**. I want to thank you gentlemen for your appearance here. I am sure it is very beneficial to this hearing.

Now the next witnesses on our panel are Donald F. Turner, from Wilmer, Cutler & Pickering; F.M. Scherer, professor of economics at the Brookings Institution; and Joseph Brodley, professor of law at Boston University.

Would you gentlemen come around and have seats whose names I just called, the panel of experts here. And thank you for your appearance.

I have another meeting I have got to go to. The distinguished Senator from Illinois is going to continue the hearing, and I will try to get back. If not, I will read your testimony in the record.

And so, Senator, if you will take charge.

Senator **Simon**. Thank you, Mr. Chairman. Unfortunately, I have to leave at 12:30, so we will have to ask you to summarize your statements, rather than read them.

The Chairman has suggested that we limit each witness to 5 minutes in oral testimony, if we could. And we will put your full statements in the record.

Mr. Turner?

STATEMENT OF PANEL CONSISTING OF: DONALD F. TURNER, OF WILMER, CUTLER & PICKERING; F.M. SCHERER, OF THE BROOKINGS INSTITUTION; AND JOSEPH F. BRODLEY, OF THE BOSTON UNIVERSITY SCHOOL OF LAW

Mr. **Turner**. Senator, I will endeavor to not summarize my prepared statement, but just put forth what I think are two or three or four important points.

It seems to me the first question that Congress is confronting here is whether an amendment of section 7 of the Clayton Act is either necessary or appropriate. And I do not think there is a clear answer to that question

As I indicated in my prepared statement, there were indeed in the past some Supreme Court and other opinions prohibiting mergers in a very excessive way. I will give you a couple of examples. In the *Von's Grocery* case, the aggregate market share was only 7.5 percent. The *Pabst Brewing* case; the Court held it was unlawful intera alia because the aggregate share of the national market was 4.5 percent.

And although the Court had earlier said, reading the congressional history, that the words "may be" did not mean a bare possibility—there had to be a reasonable probability—I think it can be said of some Supreme Court decisions, and other lower court decisions, that there was just no indication at all that the mergers they prohibited would have a reasonable probability of substantially lessening competition. So there are indeed some bad cases in the past.

But, as the administration's analysis that accompanied their proposal indicates, in recent years the decisions have been moving in the direction of a more economically rational approach. I think Mr. Ginsburg is right, that there are still occasional lower court opinions invalidating mergers where there may be an inadequate basis. And that might support incorporating into section 7 the language that was in the original legislative history; namely that an acquisition is unlawful where there is a reasonable probability that it will substantially lessen competition. I would certainly have no objection to such a proposal.

Instead, the proposed amendment changes the characterization of the test of lessening of competition to an increase in the ability to exercise market power. Now, it is possible to interpret that as being consistent with the test of reasonable probability of substantial lessening of competition; but one problem I have with that formulation is that it does appear to completely eliminate the incipiency considerations that were reflected in legislative history in 1950 under which it would make sense, for example, to make presumptively unlawful a substantial merger between two fairly good-sized companies even though it did not bring the market concentration to the threshold point where market power could be exercised.

In other words, it seems to me that the proposal would eliminate stopping very substantial mergers that were moving an industry not necessarily into the area where they could exercise market power, but moving it significantly closer.

And for a reason I am about to mention, I think it does make sense to make those mergers presumptively unlawful.

However, there is one aspect of the proposal I completely agree with. And that is, there should be an efficiencies defense to mergers. In fact, in this respect, Senator, I would go somewhat farther than the bill appears to read.

The bill seems to say that efficiencies are to be taken into account in determining whether the new statutory standard of exercise of market power is met. And my own view, which is reflected in the treatise that Professor Areeda and I wrote some years back, is that if a merger indeed does create substantial efficiency and produces a firm substantially more efficient than the two parties to the merger, that ought to be a defense to the merger even if you are in a market with relatively high concentration and it eliminates a substantial firm. Substantial economies are an economic and social benefit, even if they do not lead to a price increase, but they are probably likely to.

Let me give you an extreme example. Suppose you had an industry with only four firms, two of which each had 40 percent of the market, and there were two 10 percent firms. The two 10 percent firms merged, and there are clearly economies of scale. I think they ought to be able to merge, even though that reduces the number of sellers from four to three.

But if an efficiencies defense is recognized, then it seems to me that requiring proof of a significant probability that the merger will create or substantially increase the ability to exercise market power is not a necessary cutback, and I do not think it is an appropriate cutback.

In this connection, I think the premise stated at the outset of the administration discussion that it is generally recognized that mergers generally have procompetitive, proefficiency justification, is an overstatement, as Mr. Scherer, I am sure, will say.

Now there are a lot of economic studies indicating that, if anything, most mergers do not have efficiency properties. And therefore, I do not think we need an amendment of section 7 that substantially cuts back its scope in order to promote efficiency. All we really need is an efficiency defense.

Finally, I was sort of surprised that Secretary Baldrige said that the primary purpose of this act is to clarify the law. How he can say that it clarifies the law to require courts to consider not only six specific economic factors, but then a kitchen-sink factor, a catch-all factor? That does not clarify the law, since all of those factors are very complicated, factually and theoretically. And as a lawyer, except in a pretty clear case, I would find it more difficult to predict the outcome of a merger case under a statute like that than I would under a law in which, you know, there is presumptive illegality if the merger is substantial. Maybe if you make a clear case of very easy entry, you can get out of it and so on.

I do not think this proposal will clarify the law significantly. This is the basic problem, Senator, in merger law. There is an almost impossible dilemma between having relatively clear rules on the one hand, and at the same time achieving rules that are economically rational.

I agree with Mr. Ginsburg that moving in the direction of economic rationality probably on balance is correct. But I do think there may be some specific problems in the various areas I have described.

Thank you, sir.

Senator SIMON. Thank you, Mr. Turner.

[Prepared statement follows:]

STATEMENT

OF

DONALD F. TURNER

Wilmer, Cutler & Pickering
Washington, D. C.

Before the

Committee on the Judiciary
United States Senate

HEARING ON
S. 2160 AND S. 2022

April 9, 1986

S. 2160

S. 2160 raises two questions: whether amendment of Section 7 of the Clayton Act is necessary or appropriate; and, if so, whether the proposed amendment is properly framed. Both questions involve extremely difficult and complicated issues.

I

Is Amendment of Section 7 Necessary or Appropriate?

The legislative history of the 1950 amendment of Section 7, while not providing any precise tests for evaluating mergers, clearly indicated that illegality could not be premised merely on a reduction in the number of firms. A Senate Committee Report stated that the phrase "may be" meant that the amendment "would not apply to the mere possibility but only to the reasonable probability" of the proscribed effect on competition.[1] Moreover, the House Committee Report specifically stated that the bill did not prohibit small corporations from merging in order to establish greater competition to large companies; and quoted with approval the following statement from the Supreme Court's 1930 opinion in the International Shoe case:

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[1] S. Rep. No. 1775, 81st Cong., 2d Sess. 6 (*see* 370 U.S. 323 n.69).

> Mere acquisition by one corporation of the stock of a competitor, even though it result in some lessening of competition, is not forbidden; the act deals only with such acquisitions as probably will result in lessening competition to a substantial degree . . . that is to say, to such a degree as will injuriously affect the public.[2/]

In its first opinion subsequent to the 1950 amendment, Brown Shoe,[3/] the Supreme Court appeared to specify that determining a merger's legality would require review of a range of economic issues. However, in finding illegality in the horizontal aspects of the merger, the Court relied heavily on the combined market shares of the merging retail stores in various cities; and, in later decisions, the Court made "substantial" market shares presumptive proof of illegality, apparently rebuttable only by proof that the acquired firm was a "failing company." In Philadelphia Bank,[4/] the aggregate

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[2/] H.R. Rep. No. 1191, 81st Cong., 1st Sess. 8 (1949), citing International Shoe Co. v. FTC, 280 U.S. 291, 298 (1930).

[3/] Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

[4/] United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963).

share of the merging companies was 30 percent and the 4-firm concentration ratio exceeded 70 percent--a reasonable basis for presuming illegality. On the other hand, later Supreme Court and lower court decisions plainly went too far. For example, in Von's Grocery,5/ the aggregate share was only 7.5 percent, and in Pabst Brewing Co.,6/ the Court reached a finding of illegality in part on an aggregate share of 4.5 percent in the national beer market. In these and similar cases, it is fair to say that there was no probability at all that the prohibited mergers would have substantially lessened competition. A further serious problem in the older cases, and one still remaining to some extent, is that the Court provided no reasonable standards for defining markets, and the market definitions have been absolutely ridiculous in several cases. Finally, in two decisions that misread the congressional history, the Supreme Court indicated that economies would not be a defense to a merger otherwise thought to be unlawful.7/

5/ United States v. Von's Grocery Co., 384 U.S. 270 (1966).

6/ United States v. Pabst Brewing Co., 384 U.S. 546 (1966).

7/ Brown Shoe, supra note 3, at 344; FTC v. Procter & Gamble Co., 386 U.S. 568, 580 (1967).

However, in more recent cases, the courts have been moving toward a more economically rational approach to mergers, taking into account such factors as individual firm characteristics showing that the market share of one or both of the merging firms is not a fair indication of competitive potential, ease of entry, and size inefficiencies remediable by the merger. Indeed, the Administration, in its analysis of the Section 7 amendment proposal, states that the more refined analysis of the Department of Justice Merger Guidelines "is increasingly being adopted by the federal courts in Clayton Act Section 7 cases."

Consequently, it is doubtful that there is a pressing need for amendment of Section 7. It is true that a statutory amendment of the sort contained in S. 2160 would tend to eliminate the reappearance of such decisions as Von's Grocery and Pabst Brewing Co, but such a development seems highly unlikely. The best case is for an amendment that requires courts to take the efficiency consequences of a merger into account before reaching a conclusion of illegality. However, I understand that there are economic studies contradicting the Administration's premise "that mergers, in general, have important procompetitive and efficiency enhancing effects." Consequently, efficiency considerations do not require a substantial general liberalization of Section 7 law.

II

Analysis of S. 2160

S. 2160 rewrites Section 7 to provide that an acquisition is unlawful

> where in any line of commerce in any section of the country, there is a significant probability that such acquisition will substantially increase the ability to exercise market power.

In addition, Section 2(d) adds a paragraph that would require courts, in applying the statutory test, to consider "all economic factors relevant to the effect of the acquisition in the affected markets," including six specified factors and a "catch-all" covering any other economic evidence bearing on the statutory test.

A. Revised Test for Illegality

It could be argued that the proposed amendment is consistent with the 1950 Act legislative history specifying that illegality depends on a showing of a reasonable probability of a substantial lessening of competition. However, the legislative history also indicated, as recognized in the 1984 Merger Guidelines,[8/] that merger law enforcement

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[8/] Para. 1, last sentence.

"should interdict competitive problems in their incipiency." The latter may have implied prohibition of a merger that would substantially increase concentration even though it would not alone raise concentration to a dangerous threshold.

By requiring proof that a merger will probably "substantially increase the ability to exercise market power," S. 2160 would appear to cut back the scope of Section 7 in this respect.[9/] Such a cutback is open to question if mergers do not generally have significant efficiency enhancing effects and if proof of significant efficiencies is accepted as a defense.

As an alternative, if it were thought necessary to guard against recurrence of such decisions as Von's Grocery and Pabst Brewing, such purpose could be accomplished by amending Section 7 to prohibit acquisitions "where in any properly defined economic market there is a reasonable probability that such acquisition will substantially lessen competition now or in the future."

9/ This tendency is reinforced by S. 2160's inclusion, as a factor in assessing a merger's market power effects, of small firms' ability to increase output in response to price increases.

B. Factors To Be Considered in Applying the Test of Illegality

This proposal highlights the basic problem of formulating antitrust rules governing mergers; namely, the difficulties of reconciling the competing goals of clarity and predictability, on the one hand, and producing economically rational results on the other.[10] It is virtually impossible to formulate clear simple rules that are economically rational in that they draw an accurate line between mergers that are or are not likely to substantially lessen competition.

From an economic standpoint, determining whether or not a merger is likely substantially to lessen competition would require consideration not only of market concentration and the size of the merging firms, but also such factors as ease of entry, the nature of a product, facts bearing on the present and future competitive significance of the merging firms' market shares, and the efficiency consequences of the merger. However, such economic issues are factually and theoretically complex, are typically the subject of dispute among academic economists, and hence are difficult for courts to resolve. Moreover, entertaining a variety of factors introduces the additional problem of how they should be weighed and balanced.

10/ For an extensive analysis, *see* 4 P. Areeda & D. Turner, *Antitrust Law* ¶ 905, chs. 9B, 9C, & 9E (1980).

Thus, it makes some sense to endeavor to moderate such problems by creating presumptions of illegality based on aggregate shares and market concentration, and also narrowly defining the circumstances in which some other factors may constitute a defense and/or limiting the other factors to be considered. However, this, too, is not an easy task in light of the goal of avoiding rules that are excessively over or underinclusive. Consequently, I agree with the premise of Section 2(d) that the legality of mergers should not be predicated solely on the market structure and the size of the merging firms. However, I do believe there are questions concerning the Section 2(d) formulation.

First, with regard to the ease of entry factor, extremely low entry barriers are or should be taken into account in defining markets by including producers who can profitably sell to a particular geographic area if prices there are increased, or who can readily shift their production facilities from one product to the product in question. There may also be cases in which price increases in the past have led to new entry. In such a case, it may make sense to raise the permissible size of mergers above the normal presumptive tests, but I see no reason why such circumstances should absolve, say, a merger that totally or largely eliminates existing competition. Generally speaking, consideration of the ease of entry factor should probably be narrowly confined. In this connection, I believe that the Merger Guidelines are mistaken in considering new entry that might take place within a 2-year time period if prices are raised by 5 percent. Producers with the existing power to raise prices may and have often done so even though that induces new entry after a time. The obtainable profits may in the interim well exceed the profit reduction resulting from new entry. Moreover, potential new entrants realize that their entry will lower prices and may well not be profitable if there is already excess capacity in the industry or their entry will create excess capacity. And, entry that creates excess capacity is economically wasteful.

Second, it is doubtful that the third factor--ability of smaller firms to increase production in response to price increases--is significant enough to warrant attention in any case where concentration and the substantiality of the merger are high enough to warrant a presumption of illegality. Large firms with market power commonly are able profitably to raise prices above competitive levels, because the loss of sales to smaller competitors is more than offset by the increased net revenues on sales still made. Thus, working out the effects of small firms' ability to increase output is likely to be a difficult and highly disputed issue. Among other things, it would be necessary to get an approproximate estimate of their marginal costs.

Third, I am also unpersuaded that the fourth factor--the nature of the product or terms of sale--merits inclusion. The Merger Guidelines themselves state that while product variation is arguably relevant in all cases, practical problems dictate that the factor be taken into account only in relatively extreme cases. Moreover, even where the relevant product is very heterogeneous, so that effective tacit collusion is extremely unlikely, the likelihood of actual collusion is increased by significant increases in concentration.

Fourth, the fifth factor--conduct of firms in the market--specifically buttresses a conclusion of merger illegality where the firms have violated the antitrust laws in the past or the market has not been operating competitively. However, the fact that there have not been past antitrust violations, and that the market has been operating competitively, should not validate a merger otherwise likely to lessen competition.

Fifth, I completely agree that the sixth factor--efficiencies deriving from the acquisition--should be deemed relevant to the legality of mergers. However, as Section 2(d) is drafted, and as the Administration's analysis seems to say, the efficiency issue is tied in to the question of whether the acquisition will increase the ability to exercise market power. It should be made clear that proof of substantial efficiencies not comparably obtainable by other routes should be a defense even where the merger is likely to increase market power.

Sixth, I question the last "catch-all" factor, requiring consideration of "any other evidence" bearing on the effect of the acquisition on market power. There may well be other such facts. For example, there may be facts clearly indicating that the market share of one of the merging firms overstates or understates its competitive potential. Another example: the acquiring firm might immediately agree to license to its competitors the acquired firm's patents which the latter had refused to license, thus improving competition in significant respects. However, including the catch-all phrase would invite a flood of defensive arguments in merger cases, thus complicating the litigation. Therefore, I would be inclined to limit the catch-all factor to economic evidence clearly negating or offsetting the anticompetitive effects of the merger.

More generally, in specifying the factors to be considered in addition to market concentration and the effect of the merger thereon, I believe that such an amendment should put on defendants the burden of raising them and establishing their significance.

III

S. 2022

My comments are limited to Section 4 and Section 5 of this bill, dealing with mergers.

I question Section 4(c). First, I see no reason why divestiture should be deemed an acceptable remedy for an acquisition only if the divestiture fully restores competition lost as a result of the acquisition. If the divestiture means that the acquisition will not substantially lessen competition in any market, what remains of the acquisition does not violate Section 7. Secondly, I do not understand why approval of divestiture should be contingent on steps being taken "to protect the interest of affected employees and to preserve employment consistent with the full restoration of competition." Such a provision may preclude such efficiency steps as lowering employment costs by restructuring or by substituting machinery for labor.

I agree with the general purpose of Section 5; namely, to specify cost reduction as a possible defense to mergers. My only question is whether the defense should be made dependent upon "clear and convincing evidence that . . . the cost reduction is likely to lead to reduced prices." A merger that substantially reduces the costs of the merging firms is economically beneficial even if it is not clearly likely to lead to reduced prices. It saves resources and does put the merged firm in a better position to lower prices if it is profitable to do so.

Senator SIMON. Mr. Scherer?

STATEMENT OF F.M. SCHERER

Mr. SCHERER. Thank you very much, Mr. Chairman. It is a pleasure to be here with the distinguished Senator from my native State in the Chair.

Senator SIMON. You are a good witness.

Mr. SCHERER. If I had more time, I would address some of the data that Mr. Ginsburg presented. I would simply like to note that there are some substantial problems in those data.

The basic difficulty is that the data he presented used to be collected by the Federal Trade Commission; however, the FTC killed the messenger bearing bad news when merger activity acceleated in recent years. They simply stopped collecting data, or publishing data on mergers. And so we do not have a continuous series.

I have strived to create, out of disparate data series, a continuous series. And I find that, in the manufacturing and minerals industries, the rate of recent merger activity in constant dollar terms has been about double that at the peak of the 1960's merger wave. So something clearly is going on. It is not de minimus.

Now, the major defense, or the major rationalization, that the administration puts forward for a weakened merger policy is the expectation that it will lead to efficiencies. Over the past several years, my colleague, David Ravenscraft, and I—Ravenscraft being at the Federal Trade Commission—have compiled a very detailed data set, trying to judge the efficiencies of mergers.

In a word, we find that, on average, mergers are efficiency reducing, not efficiency increasing. I note that Mr. Baldrige very carefully said he was talking only about horizontal mergers, not about all the conglomerates. It is true, our sample consists preponderantly of conglomerate mergers, because that is all the antitrust laws allowed, at least on a large scale. We do have some horizontals, and we find that the horizontals also had questionable efficiency effects.

In his testimony, Mr. Ginsburg suggests that—I am quoting, "the most convincing evidence gathered to date comes out of stock market short-term price change studies."

Well, the fact of the matter is that the short-term price changes one observes on the stock market for horizontal mergers are very much like the short-term price changes one observes for conglomerate mergers. So if the conglomerates on average have been efficiency reducing, where is the evidence that the horizontals have been efficiency increasing?

In order to get clear insight into the kinds of mergers the administration would allow, one really cannot look at the historical U.S. experience of the 1960's and the early 1970's, one must look to Europe. There have been lots of studies of how large horizontal mergers have affected the efficiency of giant European enterprises like those referred to by Mr. Baldrige.

The upshot of those studies is that, on average, the mergers have not been efficiency increasing.

So to summarize the main thrust of my testimony, I simply do not see the evidence behind the administration's basic premise that mergers are on average efficiency increasing.

Now I readily grant that some mergers are efficiency-increasing. I join therefore with Mr. Turner in saying that we ought to have in our merger law a clearcut efficiencies defense. It seems to me, what we should do is maintain a tough presumption against concentration-increasing mergers, but then have a clear defense for those on which the parties can come forward and show with palpable evidence that efficiencies are likely to result.

Thank you very much.

Senator SIMON. I thank you.

[Prepared statement follows:]

Testimony of F. M. Scherer
before the
Committee on the Judiciary
United States Senate
April 9, 1986

The Committee has asked me to address the proposed legislation concerning corporate mergers, and in particular, Senate bills S. 2160 and S. 2161.

Before I commence, however, it might be useful to note that in my last appearance before the Committee in May 1979, I presented an analysis of merger trends in the manufacturing and mineral industries since the year 1895. At the time, I observed that there had been three great merger waves in U.S. economic history and that a new surge of mergers was appearing, but that "where [it] will take us remains to be seen."[1] Now it is possible to see whether we have had seven lean years or seven fat years since then. I have recently extended the series through 1985. Manufacturing and mineral industry acquisition activity hit an all-time constant-dollar value peak in 1984. A slight further increase is indicated for 1985, but that statistic may be slightly misleading, since the W.T. Grimm & Co. data on which it is based tally mergers at the time of their announcement, and two very large mergers,

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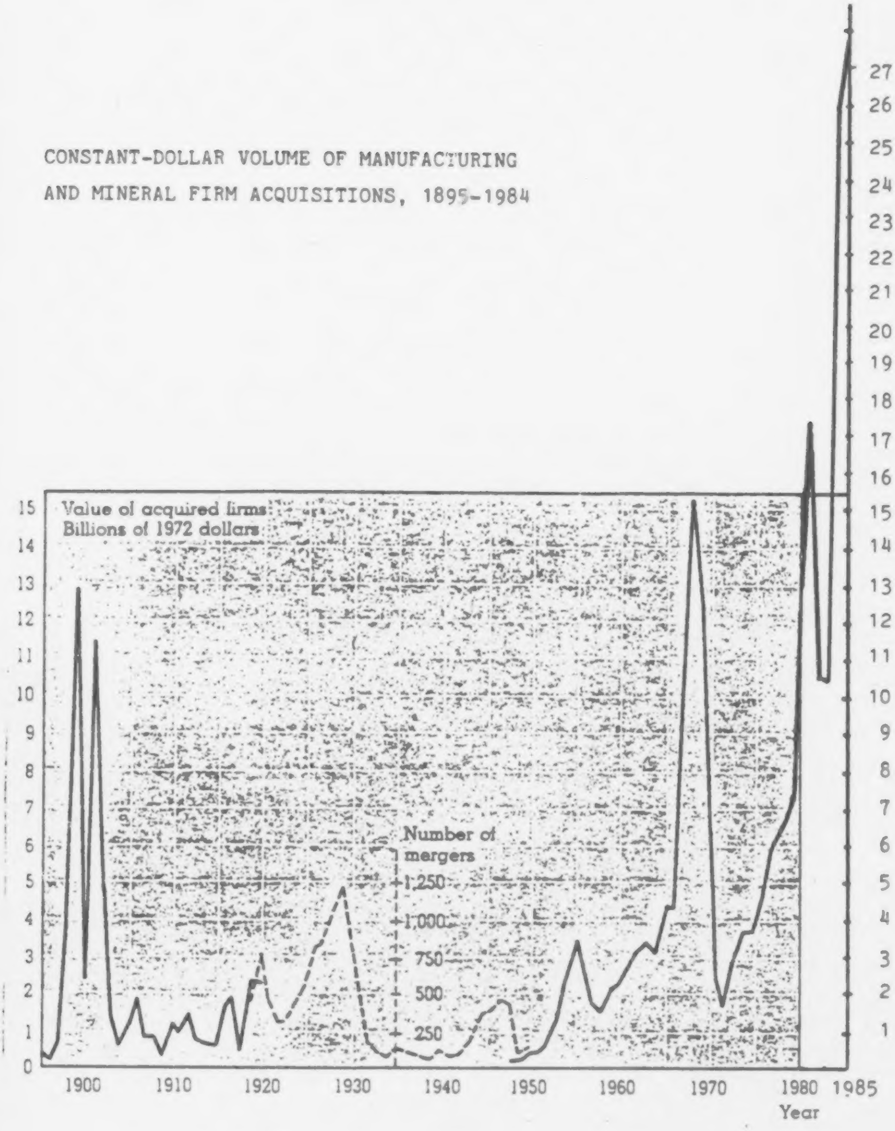
[1] Testimony before the Subcommittee on Antitrust and Monopoly, Committee on the Judiciary, Mergers and Economic Concentration, Part 2, pp. 133-149.

CONSTANT-DOLLAR VOLUME OF MANUFACTURING AND MINERAL FIRM ACQUISITIONS, 1895-1984



Sources: F. M. Scherer, Industrial Market Structure and Economic Performance (revised edition, Houghton-Mifflin, 1980), p. 120; extended using Federal Trade Commission and W. T. Grimm Co. data.

General Electric - RCA and the Kohlberg Kravis Roberts buyout of Beatrice, were announced but not yet consummated in 1985. Without them, the series would show a modest decline.

In any event, it is clear that we have not been wanting for merger activity in recent years. One might well ask, in view of the recent trends, why new legislation relaxing the existing merger statutes is required. However, rather than dealing with the issue in that rhetorical context, I should like to draw upon recent research I have conducted with David Ravenscraft of the Federal Trade Commission, with support inter alia from the National Science Foundation, the Brookings Institution, and Swarthmore College. Our research, as well as the parallel research of several European scholars, addresses some central issues that demand careful consideration.

S. 2160 would in effect shift a greater burden of proof concerning concentration-increasing mergers to the law enforcers. The Celler-Kefauver Act made it clear, both in the debate that preceded it and in singling out for proscription acquisitions whose effect "may be substantially to lessen competition," that the benefit of the doubt was to be resolved against concentration-increasing mergers. Under S. 2160, on the other hand, the plaintiff would have to bear the greater burden of showing that "there is a significant probability that such acquisition will increase the ability to exercise market power." S. 2161 would provide a limited exemption from the anti-merger laws for industries found by the President to be entitled to relief from import competition.

The principal motivation of the Administration's proposal, to paraphrase Attorney General Meese's statement of February 19, is to eliminate antitrust provisions that shackle American industries in global competition, to promote economic efficiency and consumer welfare, and to encourage innovative business activities. The key question is, will a substantial relaxation of the merger laws in fact help achieve these commendable goals?

The Efficiency Consequences of Merger

Since 1982, David Ravenscraft and I have been assembling and analyzing an extensive data base on the success of mergers in American manufacturing industry. Our sample of acquiring corporations included some 471 enterprises that accounted for roughly three-fourths of all acquisitions, by asset value, over the period 1950-1976. To the individual "lines of business" on which the parent companies reported profit and loss and balance sheet information to the Federal Trade Commission for the years 1974-1977, we linked information on more than 5,000 mergers made between 1950 and 1976 and on the hundreds of business unit sell-offs effected by the companies between 1974 and 1981. In addition, we conducted field case studies of 15 mergers that subsequently were undone through sell-off. From the analysis of these data, numerous conclusions have emerged. Let me try to summarize them very briefly:

1) Of the acquisitions covered by our study, somewhere between 25 and 35 percent were subsequently sold off or divested.

2) Our case studies revealed that the typical reason for sell-off was top management dissatisfaction with the financial performance of an acquired unit. Poor performance followed in turn from three variables, often interacting: bad luck (related inter alia to the turbulent business conditions of the 1970s); the inability of parent companies to exercise effective managerial control over their acquired units, especially when trouble appeared; and incentive breakdowns attributable to the new and more cumbersome organizational structure into which the acquired unit was fitted.

3) Our quantitative analysis confirms that low profitability is the most important factor explaining the sell-off of acquired units. On average, in the year before sell-off, a unit to be divested had an operating income / assets ratio of minus 1 percent. Non-divested units had average returns of plus 13 percent.

4) Contrary to popular impression, the business entities acquired were not companies in trouble, but were highly profitable before their acquisition. For a three-

year sample, unweighted average operating income was 20 percent of assets in the last reporting period before merger for the acquired entities. The comparable figure for all manufacturing corporations was 10.9 percent.

5) The profitability of acquired units surviving sell-off also dropped, but less precipitously, following their acquisition. An analysis of the data for 2,955 lines of business indicates that on average, profitability dropped by about one-half percentage point per year following acquisition. The decline in profits occurred even though parent companies were relatively generous in providing investible funds to their retained subsidiaries.

6) Acquisitions of companies operating in the same broad (i.e., two-digit) industrial group and horizontal acquisitions were more successful in maintaining their baseline profitability than purely conglomerate acquisitions -- i.e., those reaching out to a two-digit industry sector in which the parent had no experience. All conglomerate acquisitions had relatively high sell-off probabilities; horizontal and especially vertical acquisitions were less likely to be sold off. The only category of mergers that achieved a slight increase in baseline profitability following merger were those we called "mergers of equals," in which the two parties differed from one another in size by no more than a

factor of two. We attribute these differences to differences in managerial effectiveness. More effort is likely to be put into making "mergers of equals" work, whereas when a company acquires a much smaller firm in some unfamiliar line of business, tensions are created and the parent's skills are poorly adapted to problem-solving in the acquiree's field of operation.

7) When I refer to "baseline profitability," I mean profitability before asset and depreciation adjustments explicitly attributable to merger are made. When one analyzes profitability on the basis of post-adjustment magnitudes, one finds that the average acquisition was significantly less profitable post-merger than non-acquired units with similar market shares in the same industry. The rates of return achieved through merger were lower on average than those typically imposed by large U.S. corporations in evaluating new capital investment proposals.

8) The tender offer acquisitions in our sample were on average much less profitable post-merger than non-acquired lines of comparable industry specialization and market shares. The main reason for their inferior profitability was the large take-over premium typically paid, which inflated asset values and hence depressed operating income / asset ratios. When accounting adjustments are factored out, one finds that tender offer

acquirers neither significantly improved nor significantly worsened the baseline profitability of their acquisitions.

These findings, I believe, cast doubt on the Administration's fundamental assumption that mergers are on average efficiency-increasing, and hence are likely to enhance U.S. companies' domestic and international competitiveness. To be sure, some mergers increase efficiency. I have seen some excellent examples in my research and case study experience. But if one is going to enact a general public policy concerning mergers, one must be concerned with the average tendency, not with selected cases.

It might be argued that the kinds of mergers the Administration's policy change will encourage would have violated accepted Celler-Kefauver Act precedents, and hence are not present, or are present only in small quantities, in our historical data base. This limitation is a real one. Although our sample does include numerous horizontal mergers, the market shares involved were typically small. The "mergers of equals" we analyzed were characteristically conglomerate, not horizontal. Thus, to predict how helpful or harmful the Administration's proposals are likely to be, it would be useful to have more evidence on the efficiency effects of large horizontal mergers.

The European Experience

Fortunately, our European friends have been busy during the past two decades conducting the experiments that show us what we need to know about large mergers. Indeed, what I find particularly striking about the current United States situation is how closely the statements of Administration officials parallel the Europeans' rationale for merger policies pursued since the early 1960s.

My introduction to the subject came at a conference in Fontainebleau in 1965. The Europeans stressed repeatedly, among other things in a keynote address by finance minister Valery Giscard d'Estaing, the need for larger enterprises in order to realize economies of scale, both in production and technological innovation. This theme was stated more fully in an influential 1967 book by Jean-Jacques Servan-Schreiber. Some excerpts must serve to give the essence of his message:[2]

> [W]e find an economic system that is in a state of collapse. It is our own. We see a foreign challenger breaking down the ... framework of our societies. ... [T]he role of American industry has become even more powerful than it was ten years ago. The latest figures (1966) show that among all firms doing more than a billion dollars of business a year, 60 are in the United States and only 27 are not American-owned. ... The greater wealth of American corporations allows them to conduct business in Europe faster and more flexibly than their European competitors. ... What is most productive and decisive in the modern economy is the combination of the research factor with an industrial infrastructure, effective means of finance, and a large sales organization. The home office of a giant corporation

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[2] J. J. Servan-Schreiber, The American Challenge (translation; Atheneum, 1968), pp. xiii, 51, 6, 43, 157-8, 159, and 53.

> coordinates all of these. ... What should we do? In a nutshell: achieve a real economic union and build giant industrial units capable of carrying out a global economic strategy. ... Only a deliberate policy of reinforcing our strong points -- what demagogues condemn under the vague term of "monopolies" -- will allow us to escape relative underdevelopment. ... [T]he "secret of effective competition" does not depend entirely upon the size of a firm. Some mergers only multiply structural or management defects. But in general, the largest corporations are the ones most likely to undertake the investment and research activities essential to successful competition -- particularly in fields of advanced technology.

Since then, Europe has had very many large horizontal mergers, encouraged actively in many cases by low interest rate loans in France and the brokering efforts of the (now defunct) British Industrial Reorganisation Corporation.

There has been considerable research on how those mergers have turned out. The most ambitious study analyzed the effects of mergers across a sample of seven nations -- Belgium, France, West Germany, Holland, Sweden, the United Kingdom, and the United States. The authors summarized their findings as follows:[3]

> No consistent pattern of either improved or deteriorated profitability can therefore be claimed across the seven countries. Mergers would appear to result in a slight improvement here, a slight worsening there. If a generalization is to be drawn, it would have to be that mergers have but modest effects, up or down, on the profitability of the merging firms in the three to five years following merger. Any economic efficiency gains from the mergers would appear to be small, judging from these statistics, as would any market power increases.

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[3] Dennis C. Mueller, ed., The Determinants and Effects of Mergers (Oelgeschlager, Gunn & Hain, 1980), p. 306.

A British study concerned more narrowly with productivity increases following large mergers concluded as follows:[4]

> What has our enquiry revealed? Taking a broad sweep of the results the picture is one in which it is difficult to sustain the view that merger is in fact a necessary or sufficient condition for efficiency gain. In many cases efficiency has not improved, in some cases it has declined, in other cases it has improved but no faster than one would have expected in the absence of merger. ... There are one or two cases where we have seen an efficiency gain which has followed from the merger, these cases being where superior management has gained control over more resources. This aspect was probably the dominant view in the thinking of the [Industrial Reorganisation Corporation], but the evidence also forces us to recognize that it is just as likely that a merger based on such reasoning will fail as that it will succeed.

From another broader study of British mergers emerged the generalization:[5]

> [T]he efficiency gains, which in public policy statements have been assumed to be the saving grace of growth by takeover, cannot in the event be relied upon: strong evidence was reported that the efficiency of the typical amalgamation did not improve after merger ... it actually appears to have declined.

Two leading European scholars summarize the accumulated evidence on how larger corporate size, resulting inter alia from mergers, affects competitiveness:[6]

> Most authors find no (or a negative) relationship between firm size and profitability. Very similar

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[4] Keith Cowling et al., Mergers and Economic Performance (Cambridge University Press, 1980), p. 370.

[5] Geoffrey Meeks, Disappointing Marriage: A Study of the Gains from Merger (Cambridge University Press, 1977), p. 66.

[6] P. A. Geroski and Alexis Jacquemin, "Large Firms in the European Corporate Economy and Industrial Policy in the 1980s," in A. Jacquemin, ed., European Industry: Public Policy and Corporate Strategy (Clarendon Press: 1984), p. 347.

> results have been obtained by looking at the consequences of mergers, which usually appear to result in lower profits and sometimes even in lower growth for the acquiring firm. ... [S]tudy ... in the voluminous literature on the relation between firm size and research and development has produced a large amount of evidence "... against the hypothesis that a necessary condition for technological change and progressiveness is that firms should be large scale and dominate the market in which they operate."

All this, it seems to me, ought to be taken seriously by the Congress. We should not encourage legislation that will propel us toward emulating the failures of our international competitors. In the United States, as in Europe and Japan, the really successful competitors are characteristically those that, if large, have achieved their size by vigorous internal growth, not by gobbling up rivals. Vigorous internal growth should be encouraged. The weight of evidence suggests a much more skeptical stance toward mergers, both because their effects on average appear to have been efficiency-reducing, and because they may deflect managerial attention from efficiency-enhancing internal growth strategies toward growth-by-acquisition strategies that do little for our nation's international competitiveness.

Policy Implications

Let me emphasize again that there are exceptions to the broad statistical pattern. Some mergers do lead to efficiency gains. If the Celler-Kefauver Act is to be revised, we ought to recognize that possibility and prepare to deal with it as a special case. I would thus recommend a two-stage approach to merger enforcement. Given the evidence that on average mergers do not appear to raise efficiency, we should retain the Celler-Kefauver Act's tough presumption against concentration-increasing mergers. The burden of proof would then shift to the merger partners to show that substantial and overriding efficiencies are likely to result. In addition to distributing the evidentiary burdens upon those best able to bear them (the antitrust enforcement agencies seldom have enough knowledge to show a "significant probability" of increased market power), such a policy would have a subtle but important fringe benefit. From our case studies, I am convinced that many mergers are undertaken without careful pre-merger thought about how the two organizations will be fused effectively and what strategy will be pursued to ensure that efficiencies result. The prospect of having to convince a skeptical judge that substantial efficiencies will be realized, like the prospect of hanging in a fortnight, could marvelously concentrate the mind. If it forced managers to think through their acquisitions more carefully in advance, it could save the nation from many ill-conceived, efficiency-reducing mergers.

As an economist, I find S. 2161, the "Promoting Competition in Distressed Industries" bill, problematic. For one thing, it simply assumes that mergers will make industries hit by an import shock more competitive; it provides no evidence on the point. The numerous statistical analyses of merger after-effects, my own case studies of how mergers affected multi-plant operation and efficiency in the import-shocked French steel, textile, and shoe industries,[7] and the results of a recent Federal Trade Commission study[8] all advise skepticism. Second, as I have elaborated in testimony before a House Banking Committee subcommittee,[9] it is far from clear that import competition provides an effective check on the pricing of powerful domestic oligopolies. Given a threat from overseas competitors who have a cost or quality advantage but whose penetration into the U.S. market is at most a few percentage points per year, the long-run profit-maximizing strategy for the U.S. industry is to hold prices high and let the foreign rivals increase their market inroads. And finally, it seems to me curious to provide a remedy that permanently alters domestic market structures to deal with a problem that may be only temporary (e.g., because the dollar has risen temporarily relative to other currencies, as in the early 1980s). If injury has occurred and relief is warranted, it ought to be targeted more precisely on the special circumstances that need correction.

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[7] F. M. Scherer et al., The Economics of Multi-Plant Operation: An International Comparisons Study (Harvard University Press, 1975), especially Chapter 4.

[8] Mark W. Frankena and Paul A. Pautler, "Antitrust Policy for Declining Industries," Federal Trade Commission Bureau of Economics staff report, October 1985.

[9] Testimony before a subcommittee of the House Committee on Banking, Finance, and Urban Affairs, March 11, 1986.

Senator SIMON. Mr. Brodley?

STATEMENT OF JOSEPH BRODLEY

Mr. **BRODLEY**. Senator Simon, I am glad to be here and to have the opportunity to comment on these bills.

The basic defect in the administration proposal S. 2160 is that it would change our historic method of evolving antitrust policy—the common law method. That is to say, the antitrust statutes are phrased in language of constitutional generality—protecting competition and forbidding monopolization.

These broad statutory terms provide the framework for the enforcement activity of the Department of Justice, which has, in the merger field, devised specific guidelines; and that is all to the good. But having done that, the Department must then under the common law approach go into court and convince the court what the standards should be. The Department has failed to do this recently. It has not brought the merger guidelines to the courts. And when private litigants have sought to raise merger issues, the Department has attacked their antitrust standing. Indeed a merger case is now pending before the Supreme Court in which the Department attacks the standing of the private litigant in just this way. As a result the courts have not had the chance to involve merger law in the way that they normally would.

When Congress has intervened in the development of antitrust law, it has been in reponse to a narrowly articulated specific need. And recently Congress did respond in exactly this way in its passage of the Export Trading Company Act and the National Cooperative Research Act. In both instances Congress responded to narrowly targeted needs, which it then addressed by legislation.

By contrast, what the Department of Justice asks you to do today is to codify a particularized viewpoint. The Department asks the Congress to compress all of our concerns about competition within a single index of power over price.

Now even if this were the correct approach—and I do not think that it is—it ought not to be done. Economics and business science are not static fields. Today the Justice Department castigates the antitrust views of an earlier period but, a future generation may look back with less than full approval on their views. We ought not to freeze a specialized interpretation of competition into the Clayton Act. All of which is to show the wisdom of the more general formulation in terms of competition.

We are now at a high watermark of limited antitrust enforcement. And one can understand the motivation of those who believe in limited antitrust to incorporate their views into the statutes. But I would ask the proponents of change this question: Suppose that the antitrust decisions of the Warren Court had been codified? Suppose that even Donald Turner's estimable guidelines of 1968 had been codified? If that happened, we would now be faced with the problem of reversing enacted law. I think we ought not to be placed in that situation. The future changes.

Mr. **TURNER**. Joe, could I interrupt for just 1 minute to say that, while I may have thought my guidelines of 1968 make sense, I later decided they were far too severe. And I think the new guidelines went in the right direction.

Mr. **BRODLEY**. Yes; but I think that is what one would expect—that we learn as we go. It is easy now to say that people of former years lacked wisdom, but, you know, I have some feeling that in the future, others may say that of us, too. So I would urge that you simply to adhere to the traditional common-law antitrust approach.

In my statement, I suggest the many specific ways in which this legislation would change the substance of present law. There is time to mention only one. Suppose there is an accelerating merger trend and that the industry is rapidly becoming highly concentrated. Under the proposed increased market power standard, it may well not be possible to prove that any particular merger will itself increase the power to raise price. Indeed, it is very hard to know when that happens. And so intervention would be prevented until perhaps it was too late.

The effect of the proposed amendment on merger procedures is equally strong, and Donald Turner has spoken of that. In a word, the procedures would be made much more difficult, because under the proposed multi-factor test everything would come in. No simplification of proof would be possible.

Finally, the committee should recognize that there is a particular problem in merger litigation: everything must be proved in advance. There is no past record of conduct because the merger law has not yet occurred. The litigation comes before the event. The difficulty of advance proof explains why effective merger enforcement is possible only if injury to competition is defined under an incipiency standard.

The same problem confounds proof of an efficiencies defense. In my prepared statement I have made specific suggestions as to how it might be possible to handle an efficiencies defense—if it is to be done at all. The gist of the idea is that there ought to be a post-merger, after-the-fact audit of the efficiency claim. The details are contained in my statement.

Thank you.

[Prepared statement follows:]

TESTIMONY OF

JOSEPH F. BRODLEY

PROFESSOR OF LAW

BOSTON UNIVERSITY

This testimony discusses (1) the extent to which the Administration's proposal to modify the Clayton Act changes existing law, (2) whether the need to promote international competitiveness requires such a change, (3) whether merger law should recognize a defense based on economic efficiency, and (4) whether the standards for divestiture relief and certain other procedures in merger enforcement should be strengthened, as proposed by Senator Metzenbaum.

I. The Proposed Merger Modernization Act Would Substantially Change Existing Law

The proposed Merger Modernization Act (S. 2160) would change the basic language of the Clayton Act. The proposal would entirely strike out the central substantive test, which for 72 years has been framed in terms of upholding competition and preventing monopoly, and substitute in its place an entirely new statutory term, "increased market power." There can be no clearer signal of a fundamental policy change than the radical alteration of the core language of a statute. The proposal is all the more striking in view of the fact that no previous antitrust statute has ever used any term other than competition or monopolization, or the Sherman Act equivalent for competition--preventing restraints of trade. In Europe antitrust is even called competition policy.

Substitution of the term, "increased market power" for competition would narrow the enforcement goals of the Clayton Act and would threaten to restrict the goals of the Sherman Act and other antitrust statutes as well. The new term, increased market power, which the proposed Act defines as the ability to charge higher than competitive prices and still make a profit, is narrower than the lessening of competition language that it replaces because the new language describes only a single, immediate consequence of reduced competition--the raising of price. But competition as it has been conceived in antitrust law, both in the United States and Europe, means more than that. It means also rivalry in innovation and in quality and variety of product, equality of access to scarce resources, preservation of alternative centers of decision making and a general preference for competitive process as the social instrument for achieving material well being. Thus, the present statute aimed at maintaining competition attempts not only to prevent immediate and near term monopolisitic price increases, but also to maintain a competitive environment favorable for long run economic welfare.[1]

The new legal standard contained in S.2160 would drastically alter both the substantive content of merger law as enunciated by the courts and the method of proof in antitrust cases. In describing these changes I am not suggesting that in all respects existing merger doctrine is desirable. My point is to demonstrate how large the changes would be and how sharply this approach contrasts with the incremental common law method by which antitrust doctrine has in the past gradually evolved.[2]

Narrowing of Substantive Law

Among the changes in substantive law that S. 2160 would effect are the following:

First, and most vitally, because the proposed amendment changes the core language of the statute, it calls into doubt every prior merger decision. This disturbing result occurs because all of the prior cases were decided under a statute, the substantive heart of which would be removed. In place of the existing statutory term "may. . .substantially. . .lessen competition, or. . .tend to create a monopoly," the proposed amendment substitutes the entirely different language ". . .significant probability that the acquisition will substantially increase the ability to exercise market power."

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[1] The proposed new standard of increased market power would unsettle established norms not only under the Clayton Act, but under the Sherman Act and other antitrust statutes as well. To be sure Senate Bill 2160 redefines competition only under Section 7 of the Clayton Act, but it would raise an immediate issue of similar redefinition under the Sherman Act and other antitrust statutes. That is because under the well-known doctrine of the Hutcheson case, United States v. Hutcheson, 312 U.S. 219 (1941), which also involved an amendment to the Clayton Act, a later statutory redefinition can be read to modify earlier statutes containing the same term. The possibility is far from theoretical since several federal judges, including some recently appointed judges who were formerly law professors, are already inclined to such a reading of the antitrust statutes.

[2] The failure of the government to institute merger cases in recent years has prevented some adjustments of merger law that courts would otherwise no doubt have made. Moreover, when private litigants have sought to bring important issues of merger policy before the courts, the government--far from welcoming an opportunity to obtain a clarifying judicial ruling--has attacked the legal standing of the private litigant. Thus, when Chrysler sought to test the recent GM-Toyota joint venture in the courts, the Justice Department intervened in a purely private action to urge dismissal of the case on the ground that Chrysler lacked legal standing. See Memorandum of the United States as amicus curiae in Chrysler Corp. v. General Motors Corp., 589 F.Supp. 1182 (D.D.C. 1984). Indeed, at this very moment a private merger case is pending in the Supreme Court that raises important issues of merger policy, and once again the government is urging that the case be dismissed for lack of antitrust standing, on grounds that would effectively prevent a target firm in a takeover from ever blocking a merger because of antitrust illegality. See Cargill, Inc., Supreme Court Dkt. 85-473.

The new language is undefined in existing merger decisions of the courts. In fact, the only reliable source to which a court could turn to understand what this language means in terms of merger analysis is the source from which it was taken--the Justice Department's current Merger Guidelines. Thus, with a single stroke of the pen all prior merger precedents would be called into question.

Second, the proposed Act would change the statistical measure by which concentration is assessed, and thereby weaken the authority of the case law in still another way. The proposed Act mandates consideration of several specific factors in assessing the competitive effects of a merger, including "the number and size distribution of firms." This would replace the four-firm concentration ratio that courts have almost universally used to measure market concentration. The new formulation would arguably require use of the so-called Herfindahl Index, a mathematically complex index which measures both number and size distribution of firms and which is contained in the current Merger Guidelines. Since the Herfindahl Index has no direct analogue in the case law, it would be quite difficult to use the prior cases to determine what degree of concentration as measured by the Herfindahl Index would be excessive under the Clayton Act. Instead, courts would inevitably look to the Merger Guidelines, which are framed in terms of the Herfindahl Index. Under the standards contained in the present Merger Guidelines, almost half of the horizontal merger cases the Supreme Court has in the past held unlawful would raise no market concentration problems. See Fox, The New Merger Guidelines--A Blueprint for Microeconomic Analysis, 27 Antitrust Bull. 519 (1982).

Third, the proposed amendment provides that a merger will be unlawful only if the particular acquisition under scrutiny substantially increases the ability to exercise market power. That would appear to mean that a court could not declare a merger unlawful because it is part of an accelerating merger wave that threatens to overwhelm competition. The government would also have to prove that the particular merger was at the tipping point, and would itself move the market from competition to monopolistic conditions. This would reverse the result in Brown Shoe Co. v. United States, 370 U.S. 294 (1962), which held that under the Clayton Act courts could bar a merger that was part of an accelerating trend toward excessive concentration before monopolistic conditions had been created.

Fourth, the proposed amendment would immunize mergers in monopolistic or oligopolistic markets where the merging firms are already charging monopolistic prices. That would occur because the proposed Act condemns mergers only when they increase the ability to charge a monopolistic price and here the merger would not increase, but only perpetuate and entrench the ability to charge a monopolistic price. This perpetuates a gap presently contained in the Merger Guidelines. See Note, The CELLOPHANE Fallacy and the Justice Department's Guidelines for Horizontal Mergers, 94 Yale L.J. 670 (1985).

Fifth, the proposed amendment would apparently not reach mergers that create monopolistic buying power--the power to force prices below competitive levels--as distinct from monopolistic selling power. So long as the merger did not lead to any clear and immediate ability to increase prices on resale, the formation of abusive buying power would presumably be freely tolerated.

Sixth, for all practical purposes the proposed amendment would terminate enforcement against mergers injuring potential competition. A merger injures potential competition when it forecloses the possibility that an outside firm would enter a monopolistic or oligopolistic market. But under a legal test that would require a showing that a merger would directly enhance the ability to raise prices, it would seldom, if ever, be possible to make the necessary showing. This would reverse the result in such cases as Ford Motor Co. v. United States, 405 U.S. 562, United States v. Continental Can Co., 378 U.S. 441 (1964), and FTC v. Proctor & Gamble Co., 386 U.S. 568 (1967), and it would reject some or all of the legal doctrine ennunciated in United States v. Penn-Olin Chem. Co., 378 U.S. 158 (1964) and United States v. Falstaff Brewing Corp., 410 U.S. 526 (1973).

Seventh, the proposed amendment would also terminate the possibility of merger enforcement against vertical and conglomerate mergers. Except in the most unusual of cases a non-horizontal merger will produce no immediate ability to raise price however anticompetitive are its longer term effects. The proposed amendment would therefore reverse the results in such vertical or partially vertical merger cases as Brown Shoe Co. v. United States, supra, Ford Motor Co. v. United States, supra, and numerous lower court decisions; and it would reverse the result in FTC v. Proctor & Gamble Co., 386 U.S. 568 (1967) (entrenchment of market dominance) and FTC v. Consolidated Foods, 380 U.S. 592 (1965) (reciprocity effect).

Increased Difficulties of Proof

The proposed amendment would severely increase the government's burden of proof in merger cases. This by itself would preclude effective merger enforcement even if there were no change in substantive law. The proposed amendment mandates use of an uncabined rule of reason analysis in every merger case. Not only are six separate factors enumerated, ranging from market structure and conduct to expected efficiencies, that must be considered in every case, but in addition courts are required to consider "any other evidence" that bears on the ultimate issue of market power effects. This statutorily-mandated, unbounded approach reverses the entire course of Supreme Court development beginning in 1963 with United States v. Philadelphia National Bank, 374 U.S. 321.

In Philadelphia Bank the Supreme Court squarely confronted the fact that an open-ended judicial consideration of all conceivably relevant economic facts would make the legal consequences of a merger uncertain and thereby subvert the Congressional intent that the law be effectively enforced. To avoid that result the Supreme Court declared that whenever it was possible to do so, the courts should in the interests of sound judicial administration simplify the test of illegality, and accordingly the Court adopted a presumption of illegality for horizontal mergers based on market concentration. Subsequently, in the light of enforcement experience, the Supreme Court in 1974 modified the legal rule for horizontal mergers to allow consideration of additional economic evidence, but still within the framework of an opening presumption of illegality drawn from a limited set of accessible facts. United States v. General Dynamics Corp., 415 U.S. 486 (1974). Subsequent lower court cases have expanded and developed the General Dynamics approach, considering economic factors that appear reasonably tractable, such as entry barriers and product characteristics. See ABA Antitrust Law Developments (Second) 171-73 (1984).

The approach of the proposed amendment appears entirely different. It would place the burden on the government to prove on the basis of all pertinent economic facts that a merger creates a significant probability of substantially increasing market power. That change alone will in all probability prevent effective merger enforcement.

Merger enforcement differs fundamentally from other types of antitrust enforcement in that the trial of the case occurs before the event. Particularly under the present system of enforcement which involves pre-notification of mergers, suits are filed before the merger takes place. Thus, the assessment of competitive consequences takes place in advance. Without the aid of a simplifying presumption of illegality, however rebuttable, and with no evidentiary limitations on the type of proof that can be offered it appears unlikely that the Government could prevail, particularly on an issue requiring proof about the future behavior of prices. Instead courts would confront "the complex statistical and theoretical jungle" that vexed merger litigation prior to Philadelphia Bank, as so aptly described by Derek Bok (now President of Harvard) in an article that much influenced the Supreme Court. See Bok, Section 7 of the Clayton Act and the Merging of Law and Economics, 74 Harv. L. Rev. 226, 291 (1960). Confronted with such complexity and indeterminacy, the natural judicial tendency would be to decide the case against the party who has the burden of proof--here the Government.

It is perfectly clear, therefore, why the existing merger statute was drafted in terms of incipiency effects--a merger is unlawful if it may lessen competition--and why it was necessary for the courts to adopt simplified presumptive rules in order to implement the statutory purpose. Without such an approach there can be no adequate enforcement against complex transactions, the effects of which must be assessed in advance. If this scheme of enforcement is to be abandoned, it would be much simpler to repeal Section 7 than to weigh it down with evidentiary burdens that preclude effective enforcement.

II. The Proposed Merger Modernization Act is Not Justified By the Need to Promote International Competitiveness

It is difficult to think that the unprecedented package of major antitrust legislation, of which the Merger Modernization Act (S. 2160) is a part, would be before the Congress were it not for the claim that antitrust enforcement in some way impedes industrial competitiveness. Seemingly lending credence to the claim, the President's Commission on Industrial Competitiveness last year recommended certain modifications of the antitrust laws. But the Commission's recommendation was far more confined than the legislation now being sought, and even the need for the Commission's more limited recommendation is not established.

The President's Commission as one of its 32 separate recommendations urged certain antitrust changes, including (1) modification of the Clayton Act and other antitrust statutes to recognize efficiency gains from business combinations, (2) definition of antitrust markets to recognize global competition where it exists, and (3) the granting of antitrust exemptions for mergers and other business relationships which promote national objectives such as rationalization of production and, more generally, "the public good." See Global Competition: The New Reality, Report of the President's Commission on Industrial Competitiveness 192-93, 271 (1985). Senator Metzenbaum's Bill (S. 2022) responds directly to two of these objectives, but the Merger Modernization Act goes far beyond anything recommended by the Commission.

The Congress has in recent years been responsive to well-documented, narrowly targeted proposals to modify the antitrust laws to promote industrial competitiveness. In 1982 Congress passed the Export Trading Company Act, which provided substantial antitrust immunity for properly qualified export trading companies. In 1984 Congress passed the National Cooperative Research Act, which extended a similar substantial immunity to R&D joint ventures. Both statutes were adopted after specific showings that antitrust protection was needed to induce firms to jointly undertake activities that directly and immediately promoted U.S. competitiveness in critical areas--in the one case exports and in the other innovation.

By contrast the Merger Modernization Act--as well as most of the other antitrust legislation the Administration now proposes--reflects an entirely different approach. The proposed legislation is addressed not to a particular problem of international competitiveness, as were the 1982 and 1984 Acts, but would weaken antitrust enforcement across all economic sectors, whether or not they are impacted by foreign competition.

Certainly nothing in the Report of the President's Commission establishes the need for drastic change in merger standards. Indeed, the few facts cited in the very short discussion by the Commission of its antitrust proposals (6 pages within a 386 page report) are quite unpersuasive. For example, in arguing that U.S. firms need to be larger than they now are to compete effectively in world markets the Report presents the following data (at p. 189):

Herfindahl Index of Concentration

Country	Chemicals	Steel
United States	682	937
Japan	946	1,734
West Germany	2,226	1,442
United Kingdom	6,566	6,187
World [U.S. share]	272	393

This table is presented to show that other industrial nations allow their firms to grow much larger in national markets, and that presumably this disadvantages U.S. firms in world competition. But only a few pages earlier we discover that chemicals are one of our most successful export fields, while steel is one of our least successful. (Commission Report, p. 181) Thus, it is no more reasonable to conclude that merger constraints explain our lack of success in steel manufacturing than it is to conclude that merger constraints are responsible for our success in chemicals. Similarly, the near monopoly position allowed British Steel within the United Kingdom does not appear to have been linked with any unusual success by that firm in export markets.

Effective competition in world markets does require improved competitive strategies, but the Commission's Report fails to demonstrate that market concentrating mergers are the answer. Indeed, a principle author of the Report has recently suggested that successful strategies are much more likely to involve joint ventures and other coalitions short of merger. See Porter, Changing Patterns of International Competition, 27 Calif. Management Review 9 (1986). A similar conclusion was reached in the recent Report of the European Economic Community, which in noting the need for "fundamental structural changes" to make European industry more competitive, speaks of "facilitating cooperation between firms" not by mergers, but by joint ventures. See 15th Report on Competition Policy of the EEC (1986). Clearly amendment of the Clayton Act is not required in order to assure permissive treatment of joint ventures or recognition of efficiency benefits in joint venture cases, for the law is already permissive. See generally, Brodley, Joint Ventures and Antitrust Policy, 95 Harv. L. Rev. 1521 (1982).

Foreign Competition

The President's Commission also called for realistic definition of economic markets so as to recognize global competition where it exists. One can agree entirely with this recommendation without conceding that any amendment of the antirust laws is necessary. The Report certainly presents no evidence suggesting that modern courts are unwilling to recognize international competition where it exists. Indeed, as long ago as the Alcoa case Judge Learned Hand included in the relevant market the shipments of aluminum imports that competed with domestic production. Moreover, Judge Hand was perfectly clear in his statement that he would have included not only current imports but all foreign capacity as well, had he not concluded that tariff and other trade barriers imposed an effective ceiling on imports.

The Antitrust Improvements Act (S. 2022) contains a specific provision that would direct courts to consider foreign competition in merger or joint venture cases when any reductions in competition between U.S. firms would be offset by increased foreign sales in the United States. While this provision is declarative of present law, it would make clear that foreign sales are to be considered when it is economically realistic to do so. On the other hand, a specific provision of this kind which would apply only to mergers and joint ventures creates the possibility of a negative inference that foreign sales might be treated differently under the Sherman Act or other antitrust statute. Problems of technical construction of the specific statutory language might also arise. If all that is intended is a restatement of existing law, the provision might simply declare that foreign competition, realistically assessed, should be taken into account in defining markets for antitrust purposes.

III. Whether Merger Law Should Recognize An Efficiencies Defense

The proposed Merger Modernization Act (S. 2160) and the Antitrust Improvements Act (S. 2022) would both require antitrust courts to take economic efficiencies into account in ruling on mergers. Consideration of efficiencies in merger cases poses extreme difficulties, however, and if undertaken at all, should be done under tight constraints.

The problem with considering efficiencies in merger cases is that it would require courts to assess the outcome of a highly complex transaction before it has occurred. A merger involves a meshing of diverse and often scattered physical facilities, financial assets and personnel that were never designed to be part of a single organization. Will the union be a success or will it be a disaster? A mandatory efficiencies defense would require a court to make this exceedingly difficult assessment on a purely hypothetical basis, informed only by the claims and counter-claims of interested litigants. Under such circumstances it is difficult to think that courts could be any more successful in picking out the efficient mergers from among the inefficient than are financial analysts and managers, whose batting average is, to say the least, remarkably uneven. Moreover, the courts would not only have to identify whether a merger will produce efficiencies, but also whether such efficiencies will then outweigh anticompetitive losses, which must also be assessed in advance.

In determining whether an efficiencies defense should be introduced, it is important to bear in mind that efficiencies considerations already shape merger and other antitrust rules. Thus, the basic substantive standards for mergers are drawn with a view to permitting most mergers to go through, thereby allowing any efficiencies to be realized. Indeed, the present Merger Guidelines relaxed the standards for merger enforcement precisely to allow greater latitude for potentially efficient mergers, and recent merger cases increasingly reflect a similar viewpoint, further reducing the chance that substantial efficiencies are being lost through overly stringent merger policy. In addition, joint ventures and similar limited cooperative undertakings between firms are treated even more permissively than mergers. Since these transactions are frequently alternatives to merger, the blocking of a merger may simply rechannel the transaction into a joint venture or other less restrictive alternative, rather than bar it altogether.

Nevertheless, some believe that current antitrust rules bar a non-trivial number of mergers in which significant efficiencies could be achieved. I know of no way of testing the truth of that proposition, but even if one accepts it, it does not follow that courts should be asked to assess efficiencies in advance. Instead, we must face up to the fact that if direct assessment of efficiencies is to be undertaken in merger proceedings, an _ex post_ procedure is needed to audit whether the claimed efficiencies in fact resulted. That is, at some point following a merger approved on efficiency grounds, say after five years, the proceeding should be reopened and the parties required to prove that efficiencies were actually achieved. Where a subsequent audit determines that the promised efficiencies were not realized, additional relief should then be administered to restore competitive conditions. It is only by such a procedure that before-the-fact efficiency claims can be kept honest. In fact, a procedure of after-the-fact audit of efficiency claims is presently being followed by the Federal Cartel Office of West Germany, particularly as regards joint ventures.

Turning to the specific legislation proposed, the Administration Bill (S. 2160) would require merger courts to consider efficiencies as a factor of analysis in every merger case. This places an undue burden on the courts and complicates beyond any benefit that appears likely. The Bill fails to state explicitly who has the burden of proof on the issue, but clearly the burden should be placed on the defendants since they are the party in the best position to demonstrate the fact.

The Bill introduced by Senator Metzenbaum (S. 2022) is a much better approach to the problem, although not entirely free of difficulties. The Metzenbaum Bill would regularize the present procedure by which efficiencies are taken into account by the Antitrust Division and FTC in the exercise of their enforcement discretion. The Bill provides for a common filing procedure and specifies the kinds of cost savings that would qualify as recognizable efficiencies, properly excluding merely pecuniary savings and speculative gains, such as "learning effect" benefits. The Bill would correctly place the burden on the defendants both to demonstrate the presence of efficiencies by clear and convincing evidence and to show that the cost saving could not be achieved by a less restrictive alternative.

In addition, S. 2022 provides for a certification procedure whereby the FTC authorized to certify that a merger is likely to reduce costs and will promote competition. This can then be introduced in any future antitrust proceeding involving the merger. My problem here is that the certification does not arise out of a contested proceeding, or indeed one where anyone but the interested parties is likely to be involved. Unless provision is made for the participation of adverse litigants, it seems undesirable to allow the introduction of the certification in a subsequent proceeding except as against the government. In addition, if the FTC is to effectively monitor complex efficiency claims, it should be provided with funds to engage management consultants as independent experts in appropriate cases.

A more limited approach to efficiencies consideration in merger cases would be to limit the FTC certification procedure to joint ventures, and then to provide specifically for subsequent audit by the FTC to determine if efficiencies were in fact realized or if the restraints on competition outweighed any efficiency benefit achieved. If the results of either inquiry are negative, the unwinding of the joint venture or administration of other curative relief would present less difficulty than in a merger because the joint venture participants would have retained their separate corporate identities. When the results of this more limited efficiencies procedure could be observed, it would be possible to determine whether it is feasible to extend the procedure to mergers generally.

IV. Strengthening of Standards for Divestiture Relief and Other Procedures in Merger Enforcement

The Antitrust Improvements Act (S. 2022) proposes to strengthen the procedures in merger enforcement in several ways. Changes in antitrust procedures do not raise the same problem of undermining common law judicial development as does revision of substantive standards, and in fact there have been several procedural modifications of the antitrust statutes over the years. I would comment on two of Senator Metzenbaum's proposals that seem of particular interest: divestiture standards and access to investigatory files by state attorney generals.

With increasing frequency the relief in merger cases involves divestiture of some portion of the acquired assets. But such divestitures often raise severe problems of viability. This is not difficult to understand since the assets being divested were never designed to stand on their own or even to be part of another firm, but were intended to function within the firm from which they are now being separated. In the past many such divestitures have failed to restore competition (See Elzinga, The Antimerger Law: Pyrrhic Victories, 12 J. Law & Econ. 43 (1969) and Pfunder, Plaine & Whittemore, Compliance with Divestiture Orders Under Section 7 of the Clayton Act, 17 Antitrust Bull 19 (1972)), and it is unclear whether recent divestitures have been more successful. The provisions of S. 2022 that require strict standards of competitive viability for divested assets appear highly desirable, at least in the light of past experience. I would also suggest that Congress should require periodic reports from the enforcement agencies on the effectiveness of curative relief in merger cases. This would both provide needed information on the efficacy of merger remedies and serve as a source of discipline to enforcement agencies in administering such remedies.

State attorney generals provide a vital source of independent enforcement for the antitrust laws. Unlike private litigants they directly reflect the public interest, and yet at the same time they present a viewpoint distinct from that of federal enforcement authorities. Under the Hart-Scott-Rodino Act documents and information obtained in merger pre-notification procedures are confidential, however, and state attorney generals have been unable to obtain access to such information even for the purpose of providing federal enforcement authorities with useful comment and recommendations.

From personal experience I know how difficult it is to make informed comments on a pending merger or joint venture investigation if one lacks access to the facts being evaluated by the enforcement agency. Recently in attempting to comment to the FTC on the antitrust implications of the General Motors-Toyota joint venture, I was limited to the information published in the newspapers, although the actual joint venture agreement was no doubt on file with the FTC. As a result my comments were less informed and helpful than they might otherwise have been. It is perhaps impractical to make investigatory information available to those who represent private parties objecting to a merger or joint venture. But clearly state attorney generals could be allowed access on a confidential basis. Federal enforcement can only be improved if it receives the benefit of such comments from a sister enforcement agency.

Senator SIMON. I thank all three of you. And I wish I could ask questions. Unfortunately, I have another meeting that I have to get to.

But I think the three of you have given us something to think about. I like witnesses I agree with, and the three of you have been outstanding. Thank you very, very much. The hearing stands adjourned.

[Whereupon, the hearing was adjourned, at 12:29 p.m. at the call of the Chair.]

MERGER LAW REFORM—S. 2022 AND S. 2160

MONDAY, MAY 12, 1986

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 11:20 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Strom Thurmond (chairman of the committee) presiding.

Also present: Senators Metzenbaum and Grassley.

Staff present: Kenneth Starling, chief antitrust counsel; and Eddie Correia, minority counsel.

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

Senator METZENBAUM. In the absence of the chairman, the committee will come to order. The chairman will be with us shortly, but we will proceed forward, with his permission and understanding.

We have here today a legislative proposal that would change the standards with respect to mergers. This Senator has the feeling that the proposed standard is vague and untested. It attempts to replace a basic standard that has been on the books since 1914, and undoubtedly would lead to a lot of new questions being asked and some being answered in the way those who are proposing it would hope, but I am not at all certain will achieve the desired result.

I might point out that it is the desired result by those who are the proponents, but not the desired result of this Senator, who believes that there are too many mergers going through at the moment that are not getting the proper scrutiny that they should receive.

There is not much question that the intent of this legislation is to make it easier to merge, and we get this constant violin concerto that suggests that every piece of legislation around here is a must because it provides the answer to problems with respect to American productivity or international competitiveness.

I have heard more pieces of legislation proposed on that basis than you could shake a stick at. I have difficulty in accepting any of these legislative proposals as being the answer. There are a combination of answers as to why we are having problems, not the least of which is the failure of the American industrial complex to seriously take up the challenge of competitiveness. But they prefer to look to Congress to provide some answers that I doubt very much Congress can provide or will provide.

Suffice it to say that the only effect of this legislation will be to make it easier to merge. It will allow our major industries to consolidate to a handful of firms, driving up prices and reducing competition.

We are already in the midst of a massive merger wave, and each year we have seen a new record of larger and larger mergers. I believe we need to find ways to strengthen the law and improve enforcement, rather than weaken the law.

I further believe that this period in our American history will go down as that period of time when the Federal Government and this administration joined with America's business leaders in a massive onslaught against the antitrust laws of our Nation.

Unfortunately, I am afraid that they will be partially successful, for the very ones who have argued over the years for free competition, to be given an opportunity to work; the ones who have talked about the fact that the free enterprise system should be permitted to work, the ones who have said that they can compete if only give an opportunity to do so, they find themselves at our doorstep daily telling us to change the antitrust laws so that they really will not be competing, but will be in a better position to gobble up some of their competitors.

Mr. Chairman, I oppose this bill.

The CHAIRMAN [presiding]. Today, we will hear from distinguished witnesses on both sides of the issues. We have a written statement in favor of the bill from our distinguished colleague from Alaska, Senator Frank Murkowski, who is chairman of the Task Force on International Trade Policy of the Republican Conference.

[The following was received for the record:]

PREPARED STATEMENT OF SENATOR FRANK H. MURKOWSKI

Chairman Thurmond, distinguished members of the Judiciary Committee, I am pleased to appear before you this morning and speak in support of S. 2160, the "Merger Modernization Act of 1986". I am happy to be a cosponsor of this legislation, because I believe that it will have a significant impact on improving our global competitiveness.

We have in the United States the oldest and most vigorously enforced antitrust legislation in the world. Only 30 other nations have laws which begin to compare to our own on the subject of competitiveness. There have been some important benefits from the Sherman and Clayton Acts, among others. Clearly, the U.S. economy is much more competitive, efficient, and vigorous than it was before these Acts were passed.

Now, however, we are in a different day and age, and the antitrust laws have not kept pace with modern times. Twenty-six years ago, in 1960, only three of the world's 30 largest companies were non-U.S. concerns. But in 1984, 20 of the world's top 30 firms were owned by foreigners, and Americans own and control a minority of the global industrial power. Names such as Toyota, Nissan, Nestle, Unilever—giants in the international corporate world—are becoming household words in the U.S. The mergers that produced these corporations would be declared in violation of U.S. antitrust laws.

In the international arena, our antitrust laws have tended to have an anticompetitive effect, and this is largely the consequence of the application of Section 7 of the Clayton Act. I have information about this as chairman of the International Trade Task Force of the Republican Conference in the Senate. To understand how American firms were faring in the global marketplace, I asked Fortune and Service 500 firms to comment on what they saw to be significant obstacles to trade. Antitrust laws were mentioned frequently as restricting American enterprises in setting up joint ventures abroad, in engaging in consortium bidding, in licensing foreigners to produce patented or trademarked goods abroad, in dealing with centralized state trading companies, and in negotiating with commodity cartels like OPEC. Above all, business leaders complained of the lack of certainty. This forces them to make basic business decisions on legal, not economic grounds. They were unanimous in saying that the government should stop second guessing corporations over business operations. Executives tell us that if they are making mistakes in mergers, the market will correct them. Our government, on the other hand, takes a strong adversary stance with respect to our own firms, according to those surveyed. (I believe that results of the Trade Task Force survey would be useful to the committee in its deliberations, and I will make them available to you.) Most governments, such as the Japanese and German, encourage mergers among firms engaged in overseas selling and investment activities.

It is difficult to see how restrictions on U.S. firms that are not paralleled by restrictions on their foreign competitors can really improve competitive conditions around the world, or fail to hamper U.S. exports. The freezing out of U.S. firms does not make for greater competitiveness in world markets.

In fact, the structure of world competition has changed rapidly in the last quarter century. Adam Smith's ideal of many small firms acting by themselves in competitive markets bears no relationship to the reality of the late 20th century. Now we see large multinational enterprises, state buying and selling organizations, and cartels occupying the center of the global marketplace. This suggests that competition in such a world is more likely to be created if sellers of similar sizes on common grounds compete for the buyers' money. While U.S. firms are not small, they are increasingly dwarfed by international giants such as Hoechst, Unilever, and Mitsubishi.

Competitive conditions in the United States and abroad are much more likely to result from a common code of unfair trade practices which are uniformly enforced than from the approach which has been taken in the past by the U.S. The lesson is clear: By using arbitrary standards of U.S. market share, our companies have lost global market share.

Mr. Chairman, I have heard arguments against this legislation, chiefly that the "mergermania" of the 1980s shows that our antitrust laws do not need to be reformed—indeed, that the laws should be further tightened. I disagree emphatically, for two reasons. First, the data show no increase of concentration in U.S. industry today as compared to 10 years ago. Second, sensible business actions are frustrated by the current antitrust laws. An egregious case concerned National Steel which sought to merge with a U.S. steel company as a means to remain nationally and globally competitive. Frustrated by negative Justice Department rulings, National turned to Japan's NKK Corporation, which bought it out and proceeded to gain direct entry into the American auto market. In 1983, LTV Corporation and Republic Steel sought to merge, and the Justice Department's 1982 Merger guidelines were used to stop that action. The Department approved the merger only after the companies agreed to restructure their transactions. The present administration, in my opinion, has taken a more enlightened view toward antitrust statutes, and has been willing to interpret laws where possible in the interest of global competitive realities. What is needed is to put this attitude of enlightenment firmly and with certainty into our laws. That is what the Merger Modernization Act does, and that is why I urge you to support it.

I would add that the Act modernizes our antitrust laws without reducing protection of consumers. It makes clear that section 7 is directed against mergers that threaten to increase consumer prices. The Act protects competition and the free market process, instead of protecting competitors per se.

Thank you for this opportunity to state my views on an important proposal which, if enacted, will advance our competitive position internationally.

The CHAIRMAN. Our first panel consists of Mr. John Ong, chairman of BF Goodrich Co. and chairman of the Business Roundtable; Mr. James Rill, of Collier, Shannon & Rill, Washington, DC, on behalf of the U.S. Chamber of Commerce; Prof. Eleanor Fox, professor of antitrust law at the New York University School of Law; and Mr. James Halverson, chairman of the section of antitrust law of the ABA, and former Director of the FTC's Bureau of Competition, now practicing at Shearman & Sterling in New York.

Our second panel consists of Mr. Lloyd Constantine, assistant attorney general, State of New York, on behalf of the National Association of Attorneys General; James Baska, on behalf of the National Grocers Association; and Mr. John Satagaj, I guess that is pronounced, president of the Small Business Legislative Council.

Now, I want to express my appreciation to all you gentlemen for coming to this hearing today, which we think is an important hearing.

I will now put my full statement in the record, if there is no objection.

[The following was received for the record:]

OPENING STATEMENT OF CHAIRMAN STROM THURMOND

The Committee is continuing a series of hearings on proposals to reform merger law. The administration has recommended revising Section 7 of the Clayton Act in the manner provided by S. 2160, a bill I have introduced. This recommendation arose out of widespread feeling in the administration, business community and bar that the analysis of mergers should take adequate account of both the degree of foreign competition facing the merging firms and the competitive improvements that will be achieved by the merging firms. At our first hearing, Secretary of Commerce Malcolm Baldrige described the case for changing the merger law in this manner at this time.

Senator Metzenbaum has introduced a different set of merger law proposals which we are also considering in these hearings.

Today we will hear from distinguished witnesses on both sides of the issues. We have a written statement in favor of the bill from our distinguished colleague from Alaska, Senator Frank Murkowski, who is chairman of the Task Force on International Trade Policy of the Republican Conference.

Our first panel consists of Mr. John Ong, chairman of B.F. Goodrich Company and chairman of the Business Round Table, Mr. James Rill, of Collier, Shannon and Rill, Washington, D.C., on behalf of the U.S. Chamber of Commerce, Professor Eleanor Fox, professor of antitrust law at New York University School of Law, Mr. James T. Halverson, chairman of the Section of Antitrust Law of the ABA, a former director of the FTC's Bureau of Competition, now practicing at Shearman and Sterling, New York.

Our second panel consists of Mr. Lloyd Constantine, Assistant Attorney General, State of New York, on behalf of the National Association of Attorneys General, Mr. James Baska, on behalf of the National Grocers Association, and Mr. John Satagaj, President of the Small Business Legislative Council.

We appreciate your participation in our hearing, and we look, forward to your statements.

The CHAIRMAN. We will now proceed to the witnesses. If the first panel will come around, Mr. Ong, Mr. Rill, Ms. Fox, and Mr. Halverson.

Senator METZENBAUM. Mr Chairman, we have seven witnesses and the hour is 11:25. I wonder if the chairman would think it appropriate if we asked each of our witnesses to do that which we do so often, and that is limit their remarks to 5 minutes and put the balance of their statements in the record.

The CHAIRMAN. I think that would be all right.

Is that agreeable with you people if we take 5 minutes and give the thrust of your statement?

Mr. RILL. Yes, Mr. Chairman.

The CHAIRMAN. The entire statement will go in the record.

Mr. Ong, we will hear from you first.

Senator METZENBAUM. I want to welcome Mr. Ong. Obviously, he is a constituent of mine from Akron, OH. We are happy to have you with us this morning, Mr. Ong. I am not sure I will be in agreement with your position, but I am delighted to welcome you as one of my constituents to the hearing.

STATEMENT OF A PANEL CONSISTING OF: JOHN D. ONG, CHAIRMAN OF THE BOARD, BF GOODRICH CO., AKRON, OH, ON BEHALF OF THE BUSINESS ROUNDTABLE; JAMES F. RILL, COLLIER, SHANNON, RILL & SCOTT, WASHINGTON, DC, ON BEHALF OF THE U.S. CHAMBER OF COMMERCE; ELEANOR M. FOX, PROFESSOR OF LAW, NEW YORK UNIVERSITY SCHOOL OF LAW, NEW YORK, NY; AND JAMES T. HALVERSON, SHEARMAN & STERLING, NEW YORK, NY, ON BEHALF OF THE SECTION OF ANTITRUST LAW, AMERICAN BAR ASSOCIATION.

Mr. ONG. Thank you, Senator, and good morning to you and to our distinguished chairman. My name is John Ong. I am chairman of the BF Goodrich Co., but I am appearing today on behalf of the Business Roundtable.

The Roundtable's interest in antitrust issues is explained in the full text of the statement which I have submitted, but I am pleased that the committee has invited me to explain the Roundtable's support for this bill.

The members of the Business Roundtable represent companies that are engaged in worldwide competitive struggle. Just as one example, my company, BF Goodrich, is in the tire market. In 1971, imported tires held less than 6 percent of the market; today, they hold more than 25 percent.

As a result of this and many similar examples, U S. companies have to be efficient in order to survive. Efficiency is something that they have to work on themselves. I very much agree with Senator Metzenbaum on that point. The Government cannot do it for them.

But, by the same token, it is important that the laws that regulate business can be designed to promote rather than hinder business efficiency, and that certainly applies to the antitrust laws, in particular.

Until the middle of the 1970's, merger enforcement by both the Government and the courts was affirmatively hostile to virtually all corporate mergers, particularly those that promised efficiencies.

The Government devised a variety of new theories to attack mergers, but the underlying theme was that a merger that created a really strong, substantial competitor was bad.

Then, in the mid 70's, a rational, realistic, more practical approach to mergers began to evolve. The Supreme Court and the lower Federal courts began to focus on the real economic effect of mergers.

The antitrust enforcement agencies were also a little slower to respond, but eventually they, too, began to apply this approach to merger analysis, culminating in the 1982 and 1984 merger guidelines of the Department of Justice.

I know that there are some people who quarrel with some decisions, but I think today no one in this debate really quarrels anymore with the idea that efficiencies are a desirable consequence of mergers, as opposed to something to be condemned.

Nonetheless, the Supreme Court has never overruled the merger decisions of the 1960's; they are still on the books and they are capable of real mischief. As recently as last year, 1985, a Federal court enjoined a merger because the merged company might have the ability to lower prices.

If the appellate courts are relying on discredited economic analysis and outdated Supreme Court decisions, we can be sure that lawyers who are counseling business clients are doing the same thing. They are discouraging some mergers that would benefit the economy.

In his recent testimony before this committee, Secretary Baldrige described how two domestic truck manufacturers were discouraged from merging with each other by their counsel, only to have each company acquired by foreign corporations, and the foreign corporations were the two largest truck manufacturers in the world

As a result of all this, the Roundtable feels that reform of section 7 is necessary in order to permit rational business planning. It is simply not enough to have merger guidelines. They are not the law; they merely outline Government enforcement policy.

The law, rather, is contained in a statute with operative language that is over 70 years old and does not reflect the changes in worldwide competitive realities and in economic understanding that have occurred since 1914.

The bill before you establishes a rational framework for analysis of mergers. It identifies the factors which courts should consider in evaluating whether a merger will create market power, such as the number and size distribution of firms in the market and opportunities for entry.

It expressly allows the parties to the transaction to demonstrate that the merger creates efficiencies that could not otherwise exist.

There is nothing revolutionary about these factors; many of them were identified as long ago as the Attorney General's Report on Antitrust Law in 1955. They have been the subject of extensive economic analysis over the years. The better-reasoned court decisions are already applying them.

Senate 2160 would simply ensure that appropriate competitive factors are considered in every case, and would decrease the risk of aberrational court decisions.

Now, some critics claim that there is no reason to amend section 7, since it is not being enforced even in its present form. These critics, I think, have ignored the dramatic changes in merger enforcement that have occurred since the passage of the Hart-Scott-Rodino Act.

The Government now gets advance notice of all significant mergers. It therefore has the opportunity to negotiate with the parties in advance of closing to divest those operations that could create competitive problems. This has been done in many of the widely reported mergers, like the Chevron/Gulf merger, the Getty/Texaco merger, and many others.

In fact, my own experience would indicate that the enforcement agencies have the maximum leverage during the premerger review process. Sometimes the parties withdraw from a deal altogether when a premerger review indicates there may be problems.

But abandonments and partial divestitures which can achieve the same result the Government would have sought in litigation do not become part of the enforcement statistics.

The bill before you embodies the advances in economic understanding that have been developing since the 1960's; many years before the present administration took office, I would point out.

It is more than the philosophy of one administration; it represents a practical approach that is healthy for American business, American consumers, and our competitive position in the world.

Thank you, Mr. Chairman.

[The prepared statement follows:]

Statement of The Business Roundtable
In Support of S. 2160

My name is John D. Ong and I appear today on behalf of the Business Roundtable. I am Chairman of the BFGoodrich Company and I also am Chairman of the Business Roundtable's Antitrust and Government Regulation Task Force.

The Business Roundtable is an association of about 200 chief executive officers of substantial companies that are widely dispersed by geographic location and by category of business. The Roundtable was founded in 1972 in the belief that business executives should take an increased and open role in the continuing debates about public policy. The companies represented in the Roundtable are substantial producers and purchasers of goods and services, and therefore have a vital interest in effective enforcement of the antitrust laws. The Roundtable companies also operate in a worldwide marketplace, characterized by increasingly strong competition from foreign enterprises, and are under constant pressures to improve efficiency. It is therefore imperative that the antitrust laws be enforced in ways that enhance, rather than detract from, efficiency.

A. The Merger Laws Have Been Used to Attack Efficiencies

There is almost universal agreement today that efficiency is an important concern in antitrust enforcement, but that has not always been so. Twenty five years ago, the antitrust laws--particularly those that deal with mergers--were applied in a spirit affirmatively hostile to efficiencies. Mergers that were likely to produce a "competitive advantage" were particularly suspect, which was just another way of saying that it was illegal to seek efficiencies. One academic critic of this absurd merger policy noted at the time:

> The phrase, 'competitive advantages of larger firms' means nothing more nor less than 'economies of scale'; it only sounds different. 1/

The Supreme Court of the 1960's condemned mergers with the slightest competitive overlaps; 2/ devised fanciful scenarios of "vertical foreclosure" to strike down mergers between sellers and their customers; 3/ and invoked entirely new legal theories, like "deep-pocket" and "reciprocity", to thwart mergers of companies in entirely unrelated areas of business. 4/ The Court's hostility to mergers was so extreme that Justice Potter Stewart pointed out in dissent:

1/ Prof. Morris Adelman, quoted in R. Bork, The Antitrust Paradox 205 (1978).

2/ E.g., United States v. Von's Grocery Co., 384 U.S. 270 (1966) (horizontal overlap of 7.5% and 1.4%).

3/ E.g., Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

4/ Federal Trade Commission v. Procter & Gamble Co., 386 U.S. 568 (1967); Federal Trade Commission v. Consolidated Foods Corp., 380 U.S. 592 (1965).

> The sole consistency that I can find is that in litigation under [the merger law] . . . the Government always wins. 5/

In this context, the 1968 Merger Guidelines of the Department of Justice really represented a progressive step. Although the 1968 Guidelines were unduly restrictive--as their author, Don Turner, has candidly admitted on many occasions 6/ --they were probably considerably less restrictive than the Supreme Court would have tolerated at that time and, at least, they attempted to set forth a coherent intellectual rationale for decision. 7/ Then, in 1974, to everyone's surprise, the Government actually lost a merger case in the Supreme Court, when the General Dynamics opinion 8/ looked beyond simplistic market-share tests to take account of economic reality.

Since that time, lower court opinions have increasingly tended to take a more practical approach to mergers. There is a general recognition that a parochial and

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5/ Von's Grocery, 384 U.S. at 301.

6/ Most recently, in his appearance before this Committee on April 9, 1986.

7/ The 1968 Guidelines also demonstrated that it is entirely appropriate for responsible prosecutors to nudge the law in an anti-prosecutorial direction if they think it sensible. It is ironic that restrained law enforcement is generally applauded by the same people who today seem the most hysterical about the Antitrust Division's failure to press its powers to the utmost.

8/ United States v. General Dynamics Corp., 415 U.S. 486 (1974).

protectionist approach to antitrust will cripple the efforts of U.S. companies to compete effectively in world markets. Many courts have also been undoubtedly influenced in part by the evolution of economic theory, which has emphasized the importance of business efficiency in the enhancement of consumer welfare. These economic theories have been controversial in some respects, but their basic theme has been accepted across a wide political spectrum. In the area of merger policy, no one has argued before this Committee that efficiency is bad. People may differ about the degree to which mergers will promote efficiency, but everyone assumes that efficiency-creating mergers are desirable, even if they confer some "competitive advantage."

However, even though few people would care to defend the Supreme Court merger decisions of the 1960's, they are still on the books and still capable of mischief. It is simply not true that the broad, consensus view about the importance of efficiency will be universally applied in the absence of remedial legislation. Some courts continue to take the wooden view that mergers with slight horizontal overlaps are illegal, irrespective of other factors. 9/ Some courts continue to believe an enhanced ability to lower prices is

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9/ Christian Schmidt Brewing Co. v. Heileman Brewing Co., 753 F. 2d 1354 (6th Cir.), *cert dismissed*, 105 S. Ct. 1155 (1985).

anticompetitive. 10/ Decisions of this kind have an immediate impact on the parties before the court, but they also create so much uncertainty 11/ that lawyers may advise against efficiency-enhancing mergers. No one likes to buy a lawsuit. In his testimony before this Committee, Secretary Baldridge described how two of the leading truck manufacturers in the United States were recently sold to foreign companies, which happened to be the largest truck makers in the world, 12/ because lawyers in this country were wary of domestic mergers.

Reform of the merger law, therefore, is not an idle gesture. It would provide guidance to the courts, which now are under no obligation to follow the 1984 Merger Guidelines, and some, in fact, have refused to follow them. 13/ It would also provide assurance to the business community that the antitrust laws will no longer be used to attack mergers just because they are efficient, and it will facilitate rational business planning to meet the overseas challenge. I can tell

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10/ Montfort of Colorado, Inc. v. Cargill, Inc., 761 F. 2d 570 (10th Cir. 1985), cert. granted, 106 S.Ct. 784 (1986).

11/ For a discussion of the uncertainties in current merger law, see the panel discussion, Non Market Share Factors in Horizontal Merger Analysis, 54 Antitrust L.J. 1255 (1986).

12/ Daimler-Benz and Renault.

13/ The Tenth Circuit stated in Montfort, "these guidelines are more useful for setting prosecutorial policy than delineating judicial standards." 761 F.2d at 579.

you from personal experience that much of American industry is engaged in a dog-eat-dog competitive struggle with companies all over the world, and the stakes are very high. Antitrust is not the only government policy that affects that struggle, but it is an important one, and it is imperative that the antitrust laws be enforced in ways that help rather than harm.

B. The Merger Modernization Act Will Ultimately Make the Law More Predictable

One critic has complained that this bill will "with a single stroke of the pen" overturn all previous merger precedents, 14/ and thereby leave the courts and the bar with no authoritative guidance. This is just not so. On the contrary, the bill reflects current merger precedents, and it should enhance predictability by decreasing the risk of aberrational decisions.

The operative language of the merger law, Section 7 of the Clayton Act, 15 U.S.C. § 18, is more than seventy years old. The worldwide marketplace has changed dramatically in that time, and there have been corresponding advances in economic understanding. The existing law expresses concepts which are mutually inconsistent and which have confused courts in the past. The "substantially to lessen competition" test can suggest that the removal of, or injury to, one competitor

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14/ Prof. Joseph Brodley in his April 9 testimony before this Committee.

is wrong, whereas the "tend to create a monopoly" test suggests that any merger should be allowed if it does not threaten a single-firm monopoly. The Merger Modernization Act, on the other hand, does just what its title suggests--it uses language and embodies concepts which enlightened courts actually employ in deciding cases today.

According to the bill, the basic test for judging the legality of a merger is whether "there is a significant probability that such acquisition will substantially increase the ability to exercise market power." The bill goes on to define the exercise of market power as "the ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time." These definitions are helpful for a number of reasons:

1. Contrary to the claims of some critics, the bill does not require a prosecutor to show that competitive harm is certain to result from a merger. It does, however, require a demonstration of real probabilities, not ephemeral possibilities. This is what courts generally require today, as they should. 15/

15/ Indeed, in Brown Shoe Co. v. United States, the Supreme Court stated in construing Section 7: "Congress used the words 'may be substantially to lessen competition,' to indicate that its concern was with probabilities, not certainties." 370 U.S. 294, 323 (1962) (emphasis in original).

2. The reference to "market power," and the definition of market power as the ability to raise prices, make it clear that the law will no longer be used to attack mergers that increase efficiencies. The existing statute's reference to a threatened injury to "competition" has in the past been too easily transmuted into a threatened injury to "competitors," and that has meant invalidation of mergers where it appeared that the combined entity would have a greater capacity to lower prices. 16/ This result is flatly contrary to the welfare of consumers, with which the antitrust laws are supposed to be concerned, and suicidal as a national policy in light of the realities of foreign competition.

The Merger Modernization Act not only focuses merger policy on the real problems--threatened price increases--but also enumerates a number of factors that courts should consider in evaluating that threat. It therefore provides a framework for analysis that should assist courts considering merger cases. Again, contrary to some criticisms that have been voiced, these factors are set forth in neutral terms that do not command any result.

There is really no dispute about the importance of the factors the bill would explicitly incorporate into Section 7,

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16/ This perverse reading of the statute was the explicit basis for enjoining a merger just last year in the Cargill case, note 10 supra.

like the "number and size distribution of firms" (i); the ability of other firms to enter the market or to expand production (ii & iii); the nature of products and prior conduct of firms, which can bear on the likelihood of collusion (iv & v); and possible efficiencies arising out of the acquisition (vi). Critics have suggested instead that mandatory consideration of these factors will unduly prolong litigation and thereby make it almost impossible to attack a merger successfully. 17/

There is also nothing new or esoteric about these factors; they closely parallel those identified over thirty years ago in the Attorney General's Report! 18/ These factors have been applied in many judicial decisions. By emphasizing again that these factors are important, the bill would not cause merger cases to spin out indefinitely. 19/ The Attorney

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17/ See testimony of Prof. Brodley, note 14, supra.

18/ Report of the Attorney General's National Committee to Study the Antitrust Laws 125-27 (1955).

19/ The final "catchall" reference to "any other evidence" (vii) is not intended as an invitation to delay; it is intended to "ensure that the courts will not ignore any significant economic evidence" and to build in "additional flexibility to take proper account of further advances in economic learning." Analysis of the Merger Modernization Act of 1986 (submitted by the Administration with its legislative proposals). Actually, because major merger have to be pre-notified under the Hart-Scott-Rodino amendments, 15 U.S.C. § 18a, most merger cases are heard prior to consummation of the merger and defendants have no motive to delay.

General's Report had something useful to say on this subject as well:

> All of such facts cannot and need not be investigated in each case; only those relevant in particular market contexts, and obtainable at reasonable cost, should become part of the record. 20/

It may well be that information on some factors mentioned in the bill is simply irrelevant or too hard to obtain. For example, the threat of foreign entry can be a very significant factor when evaluating the competitive impact of mergers in some industries; in other industries, foreign competition may not be a factor at all. The point is that courts should not refuse to consider reasonably available evidence on some factors simply because other factors, such as market shares, point strongly in one direction.

In fact, in most circuits today it probably would be reversible error for a court to deny a party the opportunity to introduce evidence bearing on these factors, without sufficient reason. The Merger Modernization Act is ultimately likely to expedite antitrust litigation because it will provide more precise guidance to lower courts on the factors they should consider and the specific problem the law addresses.

20/ Attorney General's Report, note 18 supra.

C. The Attacks on the Bill Are Based on Mistaken Facts and Interpretations

Many differences of opinion are based on different value judgments that simply cannot be resolved by logical discourse. There are some people who will oppose this bill, for example, because they have a nostalgic preference for an economy with no large businesses; they are therefore generally against all mergers and opposed to this bill's efforts to distinguish with greater precision between mergers that are harmful and mergers that are benign or beneficial. In my opinion, a Government policy that implemented these notions would lead to a decline in the ability of U.S. industry to compete in world markets and a decline in the standards of living of the American people. But, if someone doesn't think that the economic well-being of our citizens is all that important, there isn't much more that can be said.

There are other criticisms of the bill, however, which are not just based on underlying value judgments, but rather on misperceptions of the facts about mergers and the impact of this bill. These are matters that can profitably be discussed and hopefully resolved. Some of them have been addressed already, such as the mistaken idea that the bill will effectively nullify merger law enforcement. However, some others need to be mentioned as well.

1. It has been suggested that the bill's focus on power over selling prices ignores other anticompetitive

consequences of some mergers, like power over purchase prices, adverse impact on quality competition, and exclusion of competitors from the market. 21/ I do not read the bill that way; I am certain it is not intended to be read that way; and if there is any doubt about it, the language of the bill itself or the Committee's Report could be appropriately modified. The ultimate objective of exclusionary tactics, for example, is to remove competitive restraints on prices, and if market exclusion were really a significant risk, the bill would cover it. Quality competition and price competition are really interchangeable; if a merger threatened, not higher prices, but stable prices for degraded products, the bill would cover it. And, surely it should not be necessary to point out that the risk of underpayments by buyers is analytically similar to the risk of overcharges by sellers.

2. It has also been suggested that mergers do not necessarily produce efficiencies, and that many mergers in the past have actually had an adverse impact on efficiency. 22/ The data for the United States are admittedly skewed because the merger law in this country has effectively discouraged horizontal mergers that might have promised the most

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21/ *See* testimony of Prof. Brodley, note 14 *supra*.

22/ *See* testimony of Prof. F.M. Scherer before this Committee on April 9.

efficiencies. The most significant thing demonstrated by these data, however, is that even a sharp critic of the bill obviously believes that efficiency-creating mergers are desirable. This is a great victory for common sense.

Beyond that, even if the data on prior merger experience is ambiguous, it does not undercut the case for this bill. As the Administration's Analysis of the bill makes clear, there is no reason for courts to consider the efficiency issue unless other factors indicate that the merger raises competitive concerns. In the absence of competitive problems, there is no case for public intervention one way or the other: the companies that have bet their own money on anticipated merger efficiencies may be right or they may be wrong, but the deal is no different from any other private contract. If competitive problems appear and companies have to demonstrate that the merger creates efficiencies that cannot be realized any other way, the facts about the transaction before the court are what will be relevant, not the history of transactions consummated long ago.

3. Finally, it has been suggested by some members of this Committee and others that merger law enforcement is currently moribund and there is no reason to award a legislative seal of approval to current enforcement policies. With respect, these comments reflect some misunderstanding of

current enforcement policies and further misunderstandings about the impact of the bill.

Both the Attorney General and the Antitrust Assistant have testified at length about current enforcement policies. Without repeating the statistics they presented, I would like to call attention to the fact that the last great merger wave occurred in the late 1960's, when the merger laws were more rigorously enforced than they have been in any other period of our history. These statistics confirm what I know from my practical business experience: merger activity can be more dependent on tax laws and on stock market prices than it is on antitrust enforcement. Antitrust laws, however written and enforced, do not create an affirmative climate for mergers, but it is also important that they do not obstruct efficiency-creating mergers and thereby channel merger activity into unproductive areas. There is some evidence that this is exactly what happened in the 1960's.

The statistics on the number of merger cases initiated by the Government can also be highly misleading. The Hart-Scott-Rodino Act, 15 U.S.C. § 18a, has dramatically changed the rules of the game. The Government now has an opportunity to review mergers in advance and it can give the parties a chance to rectify any potential problems, without the need for a formal lawsuit. This has happened repeatedly, and it has happened in mergers of great moment. 23/ In fairness to the antitrust authorities, you have to count these modified mergers if you are counting victories. You also have to examine the Justice Department's record of active participation in merger cases pending before other Government agencies, like the Interstate Commerce Commission and the Department of Transportation. 24/ In addition, the Merger Guidelines of the Department of Justice have provided better information about what the Government is likely to do, and this should have the effect of reducing litigation. When the full record is

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23/ For example, the FTC's approval of Chevron's acquisition of Gulf Oil was conditioned on entry of a consent order requiring Chevron to divest Gulf's Southeastern wholesale and retail marketing system, a major refinery in that area, and interests in certain pipeline systems. In the Matter of Chevron Corp., 104 F.T.C. 587 (1984). Similarly, in order to acquire Getty, Texaco agreed to divest interests in pipelines, a refinery, and Getty's marketing, sales, and transportation operations in 15 Midwestern states. In the Matter of Texaco Inc., 3 Trade Reg. Rep. (CCH) ¶ 22,120 (FTC 1984). See generally Grimm & Sennett, "Fix It First: The Value of Early Antitrust Planning," Vol. 8, No. 4 Legal Times 31 (April 7, 1986).

24/ Most recently, the Justice Department urged the Department of Transportation to block the proposed acquisition of Republic Airlines by Northwest Airlines. 50 Antitrust & Trade Reg. Rep. (BNA) 600-1 (April 2, 1986). It has also expressed concern about the proposed Eastern-Texas Air merger and TWA's proposed acquisition of Ozark. 50 Antitrust & Trade Reg. Rep. (BNA) 539-40 (March 27, 1986); 50 Antitrust & Trade Reg. Rep. (BNA) 640 (April 10, 1986). The Justice Department also asked the Interstate Commerce Commission to block the proposed merger of Southern Pacific Transportation Co. and the Atchison, Topeka and Santa Fe Railway Co. 49 Antitrust & Trade Reg. Rep. (BNA) 705 (Oct. 24, 1985).

considered, it is plain that this Administration has been actively involved in the merger field.

Finally, it is true that the bill embodies the same economic concepts that appear in the 1982 and 1984 Merger Guidelines. But, as we have stated, these concepts were not invented by this Administration; they existed in less sophisticated form at least 30 years ago. They are not concepts that are uniquely endorsed by one "school" of economic thought; they are in the mainstream. And, as we have also stated, the factors for decision are set out in a neutral way that does not command any result. Different prosecutors and different courts may well evaluate these factors differently; flexibility is built into the bill.

S. 2160 will not handcuff this Administration's successors. What this bill will do is codify the rational approach enlightened courts already apply, and avoid aberrational judgments based on outmoded decisions and statutory language that no longer has a meaningful economic content. Congress should not rely exclusively on prosecutors and courts to bring the law up to date. It now has the opportunity to enact a merger law that takes account of the competitive world, and our understanding of that world, as it exists at the end of the Twentieth Century.

Conclusion

On behalf of The Business Roundtable, I urge the passage of S. 2160, The Merger Modernization Act of 1986.

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Goodrich

The BFGoodrich Company
500 South Main Street
Akron, Ohio 44318

John D. Ong
Chairman of the Board

June 4, 1986

The Honorable Strom Thurmond
United States Senate
218 Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Thurmond:

I am grateful for the opportunity that was given to me to testify on May 12 at the hearing of the Senate Judiciary Committee on S. 2160, the Merger Modernization Act. I would now like to urge on behalf of both The Business Roundtable and The BFGoodrich Company that S. 2160 be reported out of the Committee with a favorable vote and to ask that you lend your efforts to gain its passage by the Senate in its current term.

There is widespread interest among the Chief Executive Officers of Business Roundtable companies in the passage of legislation that will assure that the current enforcement attitude regarding mergers will be applied uniformly by the courts and by succeeding administrations. S. 2160 will give that assurance.

The members of The Business Roundtable appreciate your personal interest in this proposal and in the other proposals for antitrust change which the Administration has put forth and I want to thank you for the many courtesies which you and the members of your staff have extended to us.

Sincerely,

John Ong

The CHAIRMAN. Mr. Rill, we would be glad to hear from you.

STATEMENT OF JAMES F. RILL

Mr. RILL. Thank you, Mr Chairman. My name is James Rill. I am appearing today on behalf of the U.S. Chamber of Commerce. The chamber supports enactment of the Merger Modification Act of 1986 because we believe that the legislation would encourage judicial interpretations that: are in accord with what have become generally accepted, modern economic antitrust principles; would be consistent with the policies of the enforcement agencies in charge of administering the antitrust laws; and are already incorporated in some, but not all, court and Federal Trade Commission decisions under section 7 of the Clayton Act.

Maximizing consumer welfare is now widely recognized as the essential purpose of antitrust law. Judge Bork succinctly put it, "The only legitimate goal of American antitrust law is the maximization of consumer welfare."

The Supreme Court, in a number of decisions, has accommodated this notion of the porpose of antitrust. For example, in *Reiter* v. *Sonotone Corporation*, the Court characterized the antitrust laws as a "consumer welfare prescription."

The Court has reiterated this objective in numerous subsequent decisions.

During the 1960's and early 1970's, it was thought that consumer welfare and antitrust objectives could be maximized simply and predictably by virtually exclusive attention to industry concentration ratios.

This presumption led to an antitrust enforcement policy and a series of judicial decisions, of intervention to stop any merger or acquisition of a horizontal nature that would significantly increase concentration in an industry, regardless of other market factors that might obtain.

The premise, however, of this structure-conduct-performance test has been shown by empirical analysis to have serious flaws. Economists Yale Brozen and Harold Demsetz were among the first to question whether, among other things, industrywide conclusions about poor performance measured by higher than competitive prices would hold true for both small and large participants in the particular industry, and many other economists have followed suit with empirical analyses to raise questions concerning the economic paradigm that was established and led to the decisions of the 1960's and 1970's.

The doubt cast on the validity of the structure-conduct-performance hypothesis, of course, does not mean that concentration and market structure are unimportant. Obviously, they are very important.

What current economic principles and the current enforcement program indicate, however, is that concentration and market structure alone will not yield an accurate description of a particular firm's performance in an industry, nor the likely competitive effects of a merger between firms.

Numerous other variables are also critically important and therefore must be considered in evaluating the likely effect of a particular merger on consumer welfare. The Supreme Court has recognized the significance of these other factors and, in its 1974 *General Dynamics* decision, abandoned analytical approaches that rely exclusively on presumptions about concentration and market structure in section 7 dispositions.

In that case, of course, the Supreme Court acknowledged that its prior decisions had found prima facie violations of the Clayton Act from statistics on the order of those relied on by the Government in the *General Dynamics* case.

The Court ruled, however, that other factors showed that the merger would not substantially lessen competition. These other factors included the history and probable future of the industry and the condition of the acquired firm and its likely future competitive force as being overstated somewhat by its market share at the time of the acquisition.

The Justice Department's 1984 merger guidelines and the FTC statement on horizontal mergers both embody the policy of taking into account not only concentration and market structure, but also other market performance factors.

The Federal enforcement agencies have come, in fact, to be the main arena for the application of economic principles to merger transactions, partly, as the preceding witness said, because of premerger notification and agency review under the Hart-Scott-Rodino amendments.

Mergers are subjected to careful analysis, and often are restructured before an agency will approve the transaction. When restructuring is not feasible nor desirable, some companies choose to refrain from consummating acquisitions when threatened with injunctive actions.

As a result, under current practice relatively few transactions are subjects of Court decisions, but the opportunity for undesirable interpretation remains.

Parenthetically, Mr. Chairman, at a recent spring meeting of the antitrust section of the American Bar Association, Assistant Attorney General Douglas Ginsburg recited the fact that he knew of at least 19 acquisitions that had been abandoned when it became known that the Antitrust Division would take action to challenge if the acquisition proceeded.

This legislation emphasizes that the issue to be determined in merger analysis is the likely ability of a firm to exercise market power, and thereby adversely affect price, entry and, in the final analysis, consumer welfare.

Some court decisions indeed have undertaken to follow these criteria. The *Echlin Manufacturing Company* decision by the FTC indicated that merger entry analysis would be the first and foremost characteristic beyond market share which would be considered.

The CHAIRMAN. I believe your time is up, Mr. Rill.

Mr. RILL. Mr. Chairman, thank you very much for your patience. The rest of my comments and reasoning is in the prepared statement, and I appreciate its being included in the record.

The CHAIRMAN. It will go in the record.

[The prepared statement follows:]

STATEMENT
on
THE MERGER MODERNIZATION ACT (S. 2160)
before the
SENATE COMMITTEE ON THE JUDICIARY
for the
U.S. CHAMBER OF COMMERCE
by
James F. Rill
May 12, 1986

My name is James F. Rill. I am a member of the law firm of Collier, Shannon, Rill & Scott. I am appearing today on behalf of the U.S. Chamber of Commerce and its Council on Antitrust Policy, of which I am a member. The Chamber supports enactment of the Merger Modernization Act of 1986 (S. 2160, H.R. 4247). Its support is based on the conclusion that the Act appropriately would encourage judicial interpretations that are:

(1) in accord with what have become generally accepted modern economic principles;

(2) consistent with the current policies of the federal enforcement agencies; and

(3) already incorporated in some, but not all, court and Federal Trade Commission (FTC) decisions under section 7 of the Clayton Act.

Furthermore, the Act would help ensure that future administrations would not deviate from the current course of merger law enforcement, a course that is well rooted in sound economic principles and that has the support of business.

I. Modern Economic Principles Hold That the Proper Focus of the Antitrust Laws Is on Consumer Welfare. Simple Concentration Ratios and Market Structure Analysis Alone Are Not Adequate Tools with Which to Evaluate the Effect of Mergers on Consumer Welfare.

For many years maximizing consumer welfare has been recognized widely as the essential purpose of the antitrust laws. As Judge Bork succinctly put it, "the only legitimate goal of American antitrust law is the maximization of consumer welfare. . . ." 1/ Consumer welfare is maximized when allocative efficiency produces the highest quality products at the lowest price. Professor Sullivan has observed that:

> It frequently is stated that the goal of antitrust is the maximization of consumer welfare. The assumption is that "consumers almost always want low prices, high quality, and convenience of distribution." Antitrust policy should encourage market behavior that produces high quality products at the lowest price. 2/

Similarly, Judge Easterbrook has concluded that "antitrust aims at preserving competition as an instrument for creating economic efficiency," 3/ and that "the antitrust laws should be treated as if their sole objective is for increasing allocative efficiency." 4/

The Supreme Court has made the same points on numerous and recent occasions. For example, in *Reiter v. Sonotone Corp.*, 5/ the Court characterized antitrust as a "consumer welfare prescription." The Court reiterated this objective in its recent decision in *NCAA v. Board of Regents of University of Oklahoma*. 6/ There, citing *Reiter v. Sonotone*, the Court observed that "a restraint that has the effect of reducing the importance of consumer preference in setting price and output is not consistent with this fundamental goal of antitrust law. Restrictions on price and output are the paradigmatic examples of restraint of trade that the Sherman Act was intended

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1/ Bork, *The Antitrust Paradox*, at 51 (1978).

2/ Sullivan, *On Non-Price Competition: An Economic and Marketing Analysis*, 45 U. of Pitt. L. Rev. 771, 785 (1984).

3/ Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 13 (1984).

4/ Easterbrook, *Is There a Ratchet in Antitrust Law?*, 60 Tex. L. Rev. 705, 715 (1982).

5/ 442 U.S. 330, 343 (1979).

6/ 104 S. Ct. 2948, 2964 (1984).

to prohibit." 7/ The underlying policies of the Sherman and Clayton Acts are no different. 8/

During the 1960's and the early 1970's, it was thought that consumer welfare could be maximized, and the antitrust laws enforced, simply and predictably by virtually exclusive attention to industry concentration ratios and presumptions about their consequences. This was the Mason-Bain "classical" structure-conduct-performance paradigm. For a time studies appeared to confirm unqualifiedly that increased levels of concentration would lead to poor industry performance demonstrated by excess profits. This presumption, in turn, suggested an antitrust enforcement policy of government intervention to stop any merger that would significantly increase concentration in any industry, regardless of other factors.

The premise of the structure-conduct-performance paradigm, however, has been shown to have serious flaws. Yale Brozen and Harold Demsetz were among the first to question whether, among other things, the industry-wide conclusions about poor performance would hold true for both large and small participants. 9/ Empirical studies suggested that the conclusions did not hold true. Other critics concluded that individual firm market share, rather than overall industry concentration, was more reliably associated with increased excess profitability (a measure of poor performance). 10/ Furthermore, the individual firm reasons for relatively large profits would have important consequences to sensible merger enforcement policy. Excess profits based on the ability to charge high prices would pose a different and substantially greater

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7/ Id. See also Continental T.V. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

8/ See generally, e.g., United States v. General Dynamics, 415 U.S. 486 (1974).

9/ Brozen, Concentration and Structural and Market Disequilibria, 16 Antitrust Bulletin 241 (Summer 1971); Demsetz, Industry Structure, Market Rivalry, and Public Policy, Journal of Law and Economics 1 (Apr. 1973).

10/ Shepherd, The Elements of Market Structure, 54 Rev. Econ. & Stat. 25 (1972). Gale, Market Share and Rate of Return, 54 Rev. Econ. & Stat. 412 (1972).

consumer welfare concern than profits based on economies of scale or other efficiencies. Scherer has summarized some of the findings as to why smaller firms in concentrated industries might not necessarily perform as profitably as the leaders do, as follows:

> [F]irms with large market shares are more profitable than firms with small market shares either because there are persistent economics of large scale, so that larger firms enjoy lower unit costs, or because for some reason, certain firms have come to have lower costs (perhaps by chance . . .) and therefore grew to have both large market shares and lower costs. 11/

Other studies found that the significance of concentration varied from industry to industry, and that in some industries no critical overall concentration ratio could be determined. 12/

The doubt cast on the validity of the structure-conduct-performance hypothesis does not mean that concentration and market structure are unimportant. Unquestionably, they are important. What current economic thought shows is the more modest but, nonetheless, significant proposition that concentration and market structure alone will not yield an accurate description of a particular firm's performance in an industry nor, a fortiori, the likely effects of the merger of firms. Numerous other variables are also important, will have different significance to the merger of different firms in different industries, and, therefore, must be considered in evaluating the likely effect of a particular merger on consumer welfare.

11/ F. M. Scherer, On the Current State of Knowledge in Industrial Economics, discussion paper IIM/IP 84-24, at 6 (Wissenschaftszentrum Berlin 1984) (emphasis in original) (summarizing Demsetz). Scherer also notes another explanation, which is that large firms may enjoy power over price because market share facilitates exploitation of product differentiation or price discrimination. Id.

12/ E.g., Geithman, Marvel & Weiss, Concentration, Price, and Critical Concentration Ratios, 63 Rev. Econ. & Stat. 346 (1981).

The Supreme Court has recognized the significance of other factors and has abandoned analytical approaches that rely exclusively on presumptions about concentration and market structure. In United States v. General Dynamics, 13/ the Court considered whether an acquisition of a strip mining coal corporation that had been acquired by a deep shaft coal mining corporation violated section 7. The government relied on concentration statistics that showed that the coal industry was concentrated and had undergone increasing trends toward concentration. The Supreme Court acknowledged that its prior decisions had found prima facie violations of the Clayton Act from statistics on the order of those relied on by the United States. The Court observed, however, that while

> the statistical showing proffered by the government's case . . . would under this approach have sufficed to support a finding of undue concentration, in the absence of other considerations, the question before us is whether the district court was justified in finding that other pertinent factors affecting the coal industry and the business of appellees mandated a conclusion that no substantial lessening of competition occurred or was threatened by the acquisition 14/

The Court resolved this question in favor of taking into account the other factors. It approved the district court's having assessed the evidence of the "structure, history and probable future" of the coal industry and of the district court's having found no substantial probability of anticompetitive effects from the merger on account of the depletion of reserves and other developments in the patterns of coal distribution and consumption. 15/

13/ 415 U.S. 486 (1974).

14/ Id. at 497-498.

15/ Id. at 500.

Correspondingly, the Department of Justice's Merger Guidelines, the FTC Statement on horizontal mergers, and the practice at both agencies is to consider not only concentration and market structure but also all other market performance factors relevant to a disciplined economic appraisal of a merger's likely effect on competition and consumer welfare. 16/

II. The Proposed Legislation Incorporates an Analytical Approach and Evaluative Criteria That Take into Account Factors of Significance Other Than Concentration and Market Structure, Making Shortcuts to the Wrong Result More Difficult.

The proposed legislation will reduce the opportunity for shortcut decisions based on assumptions about concentration and market structure that have been proven to be unreliable. The proposed legislation emphasizes the requirement for a determination of the likely ability of the firm resulting from the merger to exercise market power and, thereby, to affect adversely price, entry, and consumer welfare. 17/ The legislation provides that there must be a determination of a "significant probability" that an acquisition under scrutiny will "substantially increase the ability to exercise market power" and that in evaluating the likelihood of this effect, a court must consider all economic factors relevant to the acquisition, including not only the number and size of firms in the relevant market but also the ease or difficulty of entry, the ability of smaller firms to increase production, the nature of the product and of the terms of sale, the conduct of market participants, any efficiencies likely to be derived from the acquisition, and any other evidence relevant to whether the acquisition would increase

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16/ See, e.g., 1984 Merger Guidelines § 3.2; FTC Statement on Horizontal Mergers, §§ III, IV.

17/ Statement of Edwin Meese III, Attorney General, Before the Committee on the Judiciary, United States Senate at p. 9-10, 14 (April 9, 1986).

the ability of market participants unilaterally or collectively to exercise market power. 18/

Attorney General Edwin Meese III explained that

> [t]he Act . . . affirms that section 7 is intended to protect consumers by preserving competition rather than to benefit particular competitors. It does so by focusing merger analysis on whether firms will have the ability to raise prices to consumers as a consequence of the merger. While this approach has been increasingly accepted by courts interpreting section 7, the new language is clearer and less likely to be misapplied. 19/

III. The Merger Enforcement Program That the Legislation Endorses Promotes Legitimate Antitrust Goals

The merger enforcement procedures and evaluative criteria currently used by the Department of Justice and the Federal Trade Commission that are endorsed in the proposed legislation have promoted successfully the goals of the antitrust laws.

In Echlin Mfg. Co., 20/, for example, the Commission emphasized that while an analysis under section 7 begins with the definition of a relevant market, that approach by itself is unsatisfactory because it fails to reflect many factors that can determine whether a merger is likely to lessen competition by enabling one or more sellers to impose higher prices than would prevail under competitive conditions. It is the issue of likelihood of substantial reduction of competition that should condemn a merger, not mere increases in size or concentration. The FTC stressed that even though the "additional factors" do not lend themselves to precise mathematical expression, they often can be more important than quantitative measures of concentration.

18/ Merger Modernization Act, section 2(d).

19/ Statement of Edwin Meese III, supra, note 17 at 9-10.

20/ 3 Trade Reg. Rep. (CCH) ¶ 22,268 at 23,300 (FTC 1985).

Under the Commission's analysis in Echlin, the most important additional factor to be considered is whether barriers to entry exist. The Commission noted that an absolute barrier to entry would tend to support the original market definition by confirming that no new supply would enter a market even if prices were increased significantly above the competitive level. But if there are no barriers to entry, the original market definition loses economic significance because any attempt to exercise market power would cause new competitors to enter the market, thus driving prices back to a competitive level. Moreover, where entry barriers are low, the threat of new entry can be as potent a force as actual entry. In defining barriers to entry, the Commission noted that the inquiry must focus on industry characteristics that permit an incumbent firm to reap monopoly profits for a significant period of time, not on characteristics that increase risk or decrease profitability for all firms or affect the competitive rate of return for the industry as a whole.

In Echlin, the Commission decided that the acquisition of the nation's largest assembler of automotive carburetor kits by the third ranked firm with a combined market share approaching 50 percent would not lessen competition substantially because, objectively viewed, barriers to new entrants were nonexistent. The Commission's application of the analysis of entry barriers in Echlin was not novel; Echlin relied on an earlier decision in Grand Union 21/ where the FTC found no significant barriers to entry in the food retailing industry and on United States v. Waste Management, Inc.. 22/ Grand Union is significant in that in determining ease of entry, the Commission took into account not only new entry but also expansion by competitors already existing in the market. 23/ In Waste Management, which involved a merger approaching 50 percent of

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21/ Grand Union Co., 102 F.T.C. 812, 1063 (1983).

22/ United States v. Waste Management, Inc., 743 F.2d 976, 982 (2d Cir. 1984).

23/ Id. at 1064. See also Weyerhaeuser, 3 Trade Reg. Rep. (CCH) ¶ 22,315 at p. 23,382 (FTC 1985).

the relevant market, the court found that the prima facie case established by the market share was rebutted by evidence of low entry barriers. In addition, the court explained that the fact that entry had not happened more frequently reflected the existence of competitive, entry-forestalling prices.

Similarly, the enforcement agencies and some courts in examining the competitive effects of a merger have taken into account the potential efficiencies of a merger. In United States v. LTV Corp., 24/ for example, the District Court for the District of Columbia approved the merger of the second and sixth largest steel companies under a consent decree altering the original terms of the proposed merger. The court took into account the fact that the purpose of the merger was to achieve cost savings through increased efficiencies to enable the surviving company to compete more effectively both domestically and in the export market. 25/

While the Tunney Act, under which the court analyzed the proposed consent decree, in LTV requires a court to consider the public interest aspects of a proposed merger, the factors examined were those set forth in the enforcement agency guidelines. These included the weakened economic condition of the two companies, the condition of the steel industry as a whole, and the existence of potential and actual foreign imports. 26/

24/ 1984-2 Trade Cas. (CCH) ¶ 66,133 (D.D.C. 1984).

25/ See also General Motors Corp., 3 Trade Reg. Rep. (CCH) ¶ 22,108 at p. 22,971 (the Commission's provisional acceptance of a consent agreement with General Motors and Toyota Corp. limiting the firms' proposed joint venture the Commission took into account the fact that "the joint venture car would cost less to produce than if GM were forced to rely immediately on other alternatives," and the fact that "the venture offered a valuable opportunity for GM to complete its learning of the more efficient Japanese manufacturing and management methods.").

26/ Id. at p. 66,343.

Numerous other factors also have been taken into account in merger analysis by the enforcement agencies. In BASF Wyandotte Corp., 27/ the administrative law judge, in a decision adopted by the full Commission, found that a presumption of illegality under classic market concentration analysis had been rebutted by evidence not only of low entry barriers but because of other factors, including evidence of product characteristics that showed that the amount of actual direct competition between the merging firms that would be eliminated by the challenged acquisition was de minimis; the current market shares' exaggeration of the competitive force of the acquired company due to the disinvestment policy of the former owner of the company; competition from imports; and evidence of ineffectual marketing and technical services. The Commission also examined evidence of vigorous price competition; evidence that overcapacity in the industry tended to spur price competition and depress profitability; and evidence that smaller firms were growing rapidly and were more profitable than larger firms.

Another illustration of the application of modern economic principles in assessing whether market power could be exercised is found in Grand Union where the Commission took into account a broad range of competitive forces in determining the appropriate product market. The Commission included in the retail grocery market not only supermarkets but also "mom and pop" stores, convenience stores, and superwarehouse stores, and it clearly left open the possibility that other competitive forces, such as commissaries, also could be included in particular markets if the evidence supported that result. 28/

In fact, the federal enforcement agencies have come to be the main arena for application of modern economic principles to merger transactions. This development

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27/ 100 F.T.C. 261 (1982).

28/ 102 F.T.C. at 1046-1047 ("Unfortunately, the record does not furnish a sufficient basis to weigh with any precision the various competitive effects of such [non-supermarket] retailers.").

results in part from the premerger notification and waiting provisions of the Hart-Scott-Rodino ("HSR") amendments and the agency review that they require. Mergers meeting the HSR's jurisdictional thresholds are subjected to careful analysis and often are restructured to satisfy competitive concerns before an agency will approve the transaction. When restructuring is not feasible or desirable, some companies choose to refrain from consummating acquisitions when threatened with injunctive actions. As a result, under current practice, relatively few transactions are the subject of court decisions. But the opportunity for undesirable interpretations persists.

IV. This Legislation Is Needed to Guide the Courts and Future Administrations.

Past reliance on concentration ratios and market structure alone has and continues to result in patently undesirable judicial results. As one observer has noted, during the 1960's and early 1970's "antimerger policy became a procrustean regimen that fostered large conglomerates while hounding trivial acquisitions in 'number games.'" 29/ The courts blocked mergers of supermarkets with 7-1/2 percent of the business in Los Angeles and of breweries with 5 percent of the U.S. business, while oil companies acquired other oil companies in different geographic regions and large firms engaged in different lines of commerce combined without violating the law. 30/

As previously noted, ultimately the assumptions underlying the application of noneconomic criteria, as well as the reliance on simple concentration ratios and market structure assumptions, were discredited by modern economic thought, as well as by the Supreme Court in its own General Dynamics decision. There remains, however, a danger. The Supreme Court has not decided a merger case since its General Dynamics

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29/ Rowe, The Decline of Antitrust and the Delusions of Models: The Faustian Pact of Law and Economics, 72 Geo. L. J. 1511, 1524 (1984).

30/ Id. at 1525, collecting cases such as United States v. Von's Grocery, 384 U.S. 270 (1966), and comparing them to the FTC's Statistical Report on Mergers and Acquisitions in 1978 identifying acquisitions of assets of more than $100 million and more than $10 million such as Mobil-Marcor, itself a merger of Montgomery Ward and Container Corp.

case in 1974. There is no assurance that lower courts will not revert to the now-discredited principles often applied in the 1960's and early 1970's. Indeed, some courts today have not embraced the current economic thinking. Similarly, there is no assurance that future federal enforcement officials serving other administrations would not enforce the law, if it is not amended, from a substantially different perspective, reverting to old procedures and evaluative criteria, and moving away from those now widely believed to be a substantial improvement on the past.

V. While Some Decisions Have Accepted the Modern Economic Principles Incorporated in the Guidelines, Acceptance Has Not Been Universal.

An examination of cases decided in the last few years indicates that while there has been some acceptance of modern economic principles, this has not been true in all cases. Cases decided by the Commission and the courts in the last few years that incorporate modern principles include Grand Union, 31/ Waste Management, 32/ Calmar, 33/ Echlin, 34/ and Weyerhaeuser. 35/ In each of these cases, if the deciding body had rendered a decision based solely on old principles and presumptions about market concentration, it is likely that the mergers would not have been approved. In each case, however, application of the more sophisticated analytical framework contained in the merger guidelines compelled an examination of factors that showed the market was operating competitively and that the acquisition would not alter significantly those healthy dynamics.

31/ Grand Union Co., 102 F.T.C. 812 (1983).

32/ United States v. Waste Management, Inc., 743 F.2d 976 (2d Cir. 1984).

33/ United States v. Calmar, Inc., 612 F. Supp. 1298 (D.N.J. 1985).

34/ Echlin Mfg. Co., 3 Trade Reg. Rep. (CCH) ¶ 22,268 (FTC 1985).

35/ Weyerhaeuser Co., 3 Trade Reg. Rep. (CCH) ¶ 22,315 (FTC 1985).

In other cases, however, courts have focused almost solely on statistical evidence, to the exclusion of other evidence of market dynamics. In Monford of Colorado, Inc. v. Cargill, Inc., 36/ for example, a case where a merger between two meat packing companies was challenged by a competitor, the merging companies urged that the court should give careful consideration to the facts of the case under the merger guidelines developed by the Department of Justice. The court ruled, however, that the guidelines were not binding on its decision and relegated them to the status of guidelines for prosecutorial policy, rather than for delineating judicial standards. 37/

The Court of Appeals for the Tenth Circuit affirmed the district court's decision not to rely on the Department's guidelines either to define relevant markets or to ascertain whether the acquisition substantially would lessen competition. 38/ The appeals court commented that

> [o]n the issue of market definition, a decision based on these Guidelines remains as inexact as the data gathered to make the assessment. Market definition is by its nature an imprecise task . . .[t]he recent revision of the 1982 market definition standards only strengthens our conviction that these guidelines are more useful for setting prosecutorial policy than delineating judicial standards. 39/

The Tenth Circuit ruled that the district court had properly confined its analysis to market share statistics plus limited information on industry structure, history and

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36/ 591 F. Supp. 683 (D. Colo. 1983), aff'd, 761 F.2d 570 (10th Cir. 1985), cert. granted, 106 U.S. 591 (1986).

37/ 591 F. Supp. at 683.

38/ 761 F.2d at 579.

39/ Id.

probable future, 40/ ignoring testimony by the defendants showing, for example, that many substitutes existed for beef; that cattle supplies were cyclical; that individual plant costs differed widely; and that high costs prohibited companies from maintaining excess unused production facilities. 41/ The court observed that those factors did not resemble the factors found relevant in General Dynamics, and that "a narrow inquiry was faithful to the Supreme Court's concerns in Philadelphia National Bank that merger analysis stay within predictable bounds consistent with the limits of legal and economic certainty." 42/ The Tenth Circuit's analysis evidences a very narrow interpretation of General Dynamics and almost entirely ignores the importance of other factors that serve as a check on the accuracy of market concentration as a predictor of market power.

While other courts state that they have given some consideration to factors other than market concentration statistics, it is not altogether clear that they have been convinced of the importance of those factors, or that any amount of evidence could actually have convinced them of the importance of other factors in determining market power. 43/ Therefore, the Chamber believes that the legislation is critical to encouraging courts to employ current knowledge of economics in their merger decisions.

VI. S. 2022

I have also been asked to comment on proposals to amend the Clayton Act contained in S. 2022. Among other things, those proposals would limit the discretion of the Attorney General, the courts and the FTC to approve divestitures by requiring that a

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40/ See also Christian Schmidt Brewing v. G. Heileman Brewing, 600 F. Supp. 1326 (E.D. Mich.), aff'd, 753 F.2d 1354 (1985).

41/ 761 F.2d at 580.

42/ Id., citing Philadelphia National Bank, 374 U.S. 321, 362 (1963).

43/ See, e.g., Christian Schmidt Brewing v. G. Heileman Brewing, 600 F. Supp. 1326 (E.D. Mich.), aff'd, 753 F.2d 1354 (1985).

divestiture fully restore competition lost as a result of an acquisition; that a determination be made that buyers of divested assets be viable competitors for the foreseeable future; and that appropriate steps be taken to protect employees and preserve employment. These limitations are not practical. Often it will not be possible to know whether or how competition could be restored fully, much less whether a prospective purchaser would be a viable competitor for the foreseeable future. Nor is it clear that even if the factors contained in the legislation could be confidently ascertained, they alone would always lead to the best result in terms of consumer welfare. Generally speaking the factors represent desirable goals, but sometimes the efficiency gains of partial divestiture, asset liquidation, substitution of modern equipment, and other trade-offs that certainly are in the interest of consumer welfare will be at odds with S. 2022's limitations, particularly the social goals of preserving employment and employee status. For these reasons, the proposals in S. 2022 would not be helpful. 44/

44/ The other provisions of S. 2022 that relate to mergers either also could have undesirable consequences or are unnecessary, or both: § 5(a) limiting the type information to be taken into account regarding efficiency claims though cost reduction is unduly restrictive; § 8 providing confidential information to state attorneys general could lead to inconsistent, non-uniform enforcement policy, not to mention risking unauthorized disclosure; consideration of dissolution and recission as a private remedy, § 9, should await the Supreme Court's decision on competitor standing in Monford v. Cargill, Inc., 761 F.2d 570 (10th Cir. 1985), cert. granted, 106 U.S. 591 (1986); and § 7 lengthening the Hart-Scott-Rodino waiting period for large mergers has not been shown to be necessary.

The CHAIRMAN. Ms. Fox.

STATEMENT OF PROF. ELEANOR M. FOX

Ms. FOX. Mr. Chairman, Senators, my name is Eleanor Fox. I am here to testify today against S. 2160. In my view, S. 2160 is a bold step in the direction of dismantling antitrust.

Senator METZENBAUM. Why do you not bring the mike a little closer to you, Ms. Fox?

Ms. FOX. Yes, thank you.

This country needs a strong, economically sound antimerger law. This is especially true in this era of protectionism, deregulation and calls for national planning to fill the void.

S. 2160 is more radical even than section 7 repeal. In fact, S. 2160 is repeal of section 7 of the Clayton Act, and it is the adoption of a standard for mergers, an enhanced standard for violation that would push the threshold up somewhere between section 1 of the Sherman Act and section 2 of the Sherman Act. I think perhaps it ought to be called section 1.8 of the Sherman Act.

I would like to address the so-called needs for this section and show that they do not exist.

The two particular stated reasons are, No. 1, that mergers are efficient, they are procompetitive and they are tradeproducing; they will be the savior of American industry. As Secretary Baldrige said, considering merger ought to be the first thing on our businesses' minds.

No. 2, the claim is made that the law is inefficient; that it does not adequately consider efficiencies that make mergers good, and does not adequately consider foreign competition that makes mergers necessary and indeed prevents the merging parties from having market power.

The facts do not support these claims, and the signal to consider a merger is the wrong signal for American industry as it faces worldwide competition.

No. 1, mergers have a high risk of inefficiency and they do not address the trade gap problem. They often create bureaucracy and high costs of integration. They take tolls on morale. They often stifle inventiveness.

In industries faced with severe foreign competition, they are usually a means of evading and not confronting systemic industrial problems. While mergers are not necessarily anticompetitive, they are not necessarily bad, and antitrust is not designed to save firms from their own folly, once we face the fact that mergers are not the savior of American business, then we will be much less sanguine about the hands-off mandate of S. 2160.

No. 2, the claim that the law is inefficient, that it does not adequately deal with efficiencies and foreign competition, is simply wrong.

Just a couple of weeks ago, as an example, but a telling example, the Court of Appeals for the District of Columbia denied the motion of the Federal Trade Commission for a preliminary injunction against Occidental's acquisition of major plants of Tenneco in the PVC industry.

The court took into account the efficiencies that would come from the acquisition. It took into account the dynamic foreign competition. Although the merger caused high concentration, the court observed that the market was highly competitive and it denied the FTC's motion for preliminary injunction.

In short, the law is modern; it has already been modernized. If a need is felt for addressing the efficiency and foreign competition problem, then I think Senator Metzenbaum has done so quite well in the bill he has introduced, S. 2022. S. 2022 is a targeted approach to addressing the claims that are said to require a change of law.

I myself do not think that a change of law is necessary. I think that S. 2160 is not directed at modernization, which has already taken place. S. 2160 is directed at shrinking the law, getting the Government out of the marketplace. It is as minimal a law as one can imagine and still have an antimerger law.

It would prohibit mergers only where the plaintiff can prove as a matter of significant probability that the particular merger will substantially increase price over current price and for a significant period of time. This is an ostrich's perspective of what is anticompetitive.

Of course, increasing price over current price is bad, but it is not the ballgame. The ballgame is going to be fought on technological competition, not price competition. I have given in my written testimony a hypothetical example of AT&T making a breakthrough in computer technology, IBM acquiring AT&T, and the Justice Department economists saying, well, it does not increase price over current price, and it is not caught by the law.

Yet, it would be clear that such a merger, which eliminates technological competition, is bad for America.

I have stated in my written testimony the other ways in which the proposed law is much narrower than current law, does not catch anticompetitive mergers, and would do away with the presumptions and burden-shifting that make our present law administrable and practicable.

I urge the committee to consider the strength of the existing law and not to dismantle it.

Thank you, Mr. Chairman.

[The prepared statement follows:]

Statement of
Eleanor M. Fox
Professor of Law
New York University School of Law

on S. 2160, a bill to amend
Section 7 of the Clayton Act

Before the Committee on the Judiciary
United States Senate

May 12, 1986

I. Introduction

Mr. Chairman and Members of the Committee, it is my pleasure to testify before you today on the antitrust merger bill, S. 2160, a bill to amend the country's principal merger law, Section 7 of the Clayton Act. The bill would essentially repeal Section 7 of the Clayton Act, and I testify against it.

Section 7 of the Clayton Act proscribes mergers whose effect may be substantially to lessen competition. Section 7 was enacted, and amended in 1950, because the Sherman Act was thought not sufficient to catch mergers that in themselves or cumulatively significantly threatened to lessen competition. See Brown Shoe Co. v. United States, 370 U.S. 294, 318 n.32 (1962). Through later case law the Supreme Court brought Section 1 of the Sherman Act, which prohibits unreasonable restraints of trade, in line with Clayton 7. United States v. First National Bank & Trust Co. of Lexington, 376 U.S. 665 (1964).

If Section 7 were "merely" repealed, the country could fall back on Section 1 of the Sherman Act to protect it against anticompetitive mergers. But S. 2160 is more radical even than Section 7 repeal. It places the threshold for illegal mergers somewhere between the proscriptive standards of Section 1 of the Sherman Act and those of Section 2 of the Sherman Act; thus, between the "merely" anticompetitive and the monopolistic.

I would like to explain why I think this proposal is precisely the wrong way to meet the challenge of world competition.

II.

The proposal is based on the notion that mergers are presumptively efficient, procompetitive, and the salvation of American business. This notion is wrong.

Effective competition requires, above all, responsiveness. Responsiveness requires attaining economies of scale, drawing upon the best talents of the firm including its workers, and inventing to meet or beat the highest level of technological advance in the world.

Minimum economies of scale are normally attained at low market shares, often in the area of 3% of U.S. demand. F.M. Scherer, Industrial Market Structure and Economic Performance (2d ed. 1980), p. 31 et seq., esp. p. 96. Mergers of a size necessary to achieve scale economics are perfunctorily allowed. It would be a rare case in which a merger to achieve economies of scale would even be suspect under the merger law. See Kauper, "The 1982 Horizontal Merger Guidelines: Of Collusion, Efficiency and Failure," 71 Calif. L. Rev. 497, 519 (1983). Mergers of firms beyond economic scale might hold the promise of other cost-savings to the firm, but for all cost-savings to be realized by sizable mergers, there also are costs. There are costs of integration and bureaucracy; tolls on morale and tolls on productivity; frequently, a loss of ingenuity. See, e.g., Hayes, "Too Much Dictating From The Top: Why Strategic Planning Goes Awry," N.Y. Times, April 20, 1986, F2, c.3; Clemens and Mayer, "History's First Takeover Expert: Before Pickens, There Was Machiavelli," N.Y. Times, March 2, 1986, F3, c.1.

Moreover, large mergers frequently are financed by heavy debt, the debt service is enormous and small market changes can throw the new firm into financial straits. Short term strategies to sell off assets and survive can quickly replace the dreams of becoming the best. E.g., "Do Mergers Really Work?", Bus. Week, June 3, 1985, p. 88; "Why Many Mergers End Up On the Rocks," Editorial, Bus. Week, June 3, 1985, reporting that one out of every three mergers fail or is otherwise undone, "and many more struggle on in a kind of slow death." Id. at 126.

Even in industries faced with severe competition from cheaper or better imports, mergers of dimensions that would pose antitrust problems are not normally a promising solution for the country's systemic industrial problems. As an FTC economic study recently found:

> [T]he problems caused by decline are not likely to be efficiently solved through changes in antitrust policy. Rather, income subsidies and macroeconomic policies might be more appropriate means of addressing the employment and trade problems that might be associated with industrial decline.

Frankena and Paulter, Antitrust Policy for Declining Industries, Bureau of Economics, FTC (Oct. 1985), p. 66.

The Bureau of National Affairs recently reported on testimony of Secretary of Commerce Baldrige before this Committee. As BNA wrote: "'Consider a merger' is a message [Secretary Baldrige] wants sent out to the business community." 50 BNA Antitrust & Trade Reg. Rep. 627 (April 10, 1986). "Consider a merger" is the message of S. 2160. This message is a wrong and dangerous signal. Mergers are not the hope for America.

Mergers are not necessarily anticompetitive, they are not necessarily bad, and the antitrust laws are not designed to save companies from their own follies. But once we face the fact that mergers are not the saviour of American business and that in troubled industries they are more likely to reflect avoidance than confrontation of the root problems, then we will be much less sanguine about the hands-off mandate of S. 2160.

III.

S. 2160 would change Section 7 of the Clayton Act, a statute that proscribes mergers likely to lessen competition, into a highly complex technical statute with a very high threshold for violation. The new law would, if passed, proscribe only those mergers that create the significant probability of substantially increasing the ability of firms "profitably to maintain prices above competitive levels for a significant period of time." The courts are directed to consider all economic factors relevant to a determination of substantial increased pricing power, including number and size distribution of firms, ease of entry of foreign or domestic firms, ability of fringe firms to expand, nature of the product, firm conduct, and efficiencies.

This call for a new enhanced standard for violation is made on grounds that the existing law is perverse, that it carries the protectionist baggage of the 1960s, that it does not adequately take account of "modern" economics, and that it does not appropriately reflect foreign competition. I will show that existing law has none of these qualities; it is totally modern and responsive to contemporary economic conditions, and no statutory change is called for to accomplish any of this "modernization." Thus, S. 2160 cannot be explained as a bill to accomplish modernization. That would be redundant, and indeed that is not its purpose. S. 2160 does something much different. It would shrink the scope of the merger law so that even anticompetitive mergers (if not substantially price-raising) are permitted. It is a piece of a larger attempt to dismantle antitrust.

I would like to address some of the assertions of "need" for S. 2160. I will show that these stated needs do not exist.

(1) Do we need a new law to assure that courts, in analyzing mergers, adequately consider foreign competition?

The answer is no. Courts always consider foreign forces that pressure domestic firms to compete and that keep them from getting or exercising market power. Courts have, for decades, considered real (as opposed to theoretical and unlikely) forces of foreign competition. See, e.g., United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945).

Courts today routinely consider foreign competition. See 1 Fox and Fox, Corporate Acquisitions and Mergers § 8.02[2][t] (1985) (copy of relevant excerpt attached).

(2) Do we need a new law to assure that courts, in analyzing mergers, will take account of modern economics?

The answer is no. Modern merger law is filled with sound economic analysis. Courts do not prohibit productive mergers. See Fox and Fox, supra.*

It is only those individuals who insist that all mergers must be efficient or the firms would not have opted to merge who see merger law, indeed most law, as anti-efficiency. See Interview with Robert Tollison, [then] FTC's Chief Economist, 43 BNA Antitrust & Trade Reg. Rep. 609, 610-12 (Sept. 30, 1982).

(3) Do we need a new merger law to get rid of 1960s baggage?

The answer is no. In the 1960s the courts condemned almost all big mergers. They reflected, as Congress reflected, a bias against bigness and, indeed, a bias against mergers. This is not the case today. The Supreme Court has changed the face of the antitrust laws, beginning with three merger cases in 1974. United States v. General Dynamics Corp., 415 U.S. 486 (1974); United States v. Marine Bancorporation, 418 U.S. 602 (1974); United States v. Connecticut National Bank, 418 U.S. 656 (1974).* Small and middle sized companies especially in fragmented markets are no longer vulnerable to challenge.

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* Even courts that apply the law's rebuttable presumption against increasing concentration in already highly concentrated markets, for combined reasons of social policy and administrability, normally apply sound economics and do not abort mergers that increase competitive effectiveness. Those who would wipe out law and apply only economics accompanied by a strong presumption that business "freedom" will best cure market failures do not have a monopoly on sound economics.

All law evolves. In the late 1960s we had the Merger Guidelines of 1968, which were a rendition of then Supreme Court case law, adopted for guidance in enforcement only. The 1968 Guidelines commanded the general public support. There was no call to alter the statute itself in order to codify the Guidelines, as could have been done.

Through case by case decision, the law changed, as law should change, adapting to a changing social and economic environment.

Now we have the Reagan Administration's 1984 Guidelines, which command much less public support than did the 1968 Guidelines in their time. The Administration Guidelines (first promulgated by Assistant Attorney General Baxter in 1982) were an explicit attempt to lead the law, not to reflect the law, and to lead it in the direction of Tollison's natural experiment.*

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* In later developments outside of the merger field, but in decisions reflecting broadly on antitrust policy, the Supreme Court made it clear that the law does not condemn transactions that help firms to compete more effectively. E.g., Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977); Broadcast Music, Inc. v. CBS 441 U.S. 1 (1979).

The law has rid us of the 1960s baggage. The language of Section 7 has weathered well the changing notions of appropriate competition policy. The language of Section 7 will weather well, into the Twenty-First Century, because the statute is written in basic language of preserving competition.

The Congresses of 1914 and 1950 served us well. We cannot improve on their handiwork. We now know that it would have been bad social policy if Congress had codified the Guidelines of 1968. We should foresee that it would be bad social policy to codify the Guidelines of 1984.

(4) If statutory surgery is not needed to modernize the law, what, then, is the driving force behind S. 2160?

The most apparent purpose of S. 2160 is to move society further along towards the minimal state; to give business, especially bigger business, greater freedom; to take the Government almost completely out of the marketplace.

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* See Interview with Robert Tollison, supra. Tollison would "allow a lot of mergers to go through[;] . . . allow a lot of people to put their money on the line . . . . We get a natural experiment in the economy going. Let firms merge, and see what happens." 43 BNA Antitrust & Trade Reg. Rep. at 612.

S. 2160 would accomplish this end. Plaintiffs' merger cases will be nearly impossible to win. Suppose, for example, that it is 1990. S. 2160 is law. AT&T has just developed, on the drawing boards, the most promising computer system in the world, making a breakthrough that eluded even IBM. IBM announces that it will acquire AT&T. IBM and AT&T assert to the world that only by their combination and in view of their synergies will the United States win the world-wide race to dominate data and communications markets.* The Justice Department investigates. The Government economists take current price as a given, as the statute requires them to do, and asks whether, as a result of the merger, price will probably increase substantially above current price for a significant period of time. They come back with their answer. The answer is no. The merger "merely" would have the effect of eliminating important technological competition. It would not raise price over current price, let alone substantially, and let alone for a significant time. The Justice Department closes the books.

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* The idea that IBM and AT&T should engage in market strategies to minimize their technological competition is not fanciful. See "Backstage with Big Business," Washington Post, Feb. 1, 1981, F1, reporting IBM's test-marketing of telephone equipment products, AT&T's then perceived weak technological position in the area, conversations between IBM and AT&T officials, and a decision by IBM not to launch a competitive challenge.

As the IBM-AT&T example shows, a deep problem of S. 2160 is not what it includes but what it ignores.* While courts do invalidate mergers that substantially increase the power to raise price above existing price for a substantial time, and all of the economic factors listed in S. 2160 are relevant to that inquiry, it is not the case that only such mergers are anticompetitive (and therefore illegal under existing law). Mergers are also anticompetitive (and now illegal), for example, when they significantly lessen technological competition,[*] when they significantly lessen consumer alternatives in an already highly concentrated market, and when they significantly close off opportunities for competition to break out in sluggish markets. They are also anticompetitive when, together with mergers of similarly placed firms, any of these effects is significantly likely to occur.[**]

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* S. 2160 essentially codifies the Reagan Administration Merger Guidelines, and I have analyzed elsewhere the ways in which the Guidelines would catch far fewer harmful or potentially harmful mergers than does current law. I attach excerpts from my articles, "The 1982 Merger Guidelines: When Economists are Kings?," 71 Calif. L. Rev. 281 (1983); "The New Merger Guidelines — A Blueprint for Microeconomics Analysis," 27 Antitrust Bul. 519 (Fall 1982).

A second major flaw in S. 2160 is that it would throw out presumptions that the courts have honed over the years, that are economically sound, and that provide the law with administrability and clarity. See, e.g., for an example of presumptions and burden-shifting, United States v. Marine Bancorporation, 418 U.S. 602 (1974).

Conclusion

Section 7 of the Clayton Act proscribes anticompetitive mergers. The law is sound; it is the product of organic evolution. We should support the law and not dismantle it.

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[*] W. Baxter, P. Cootner and K. Scott, Retail Banking in the Electronic Age (1977) pp. 84-86, 176 (regarding electronic funds transfer systems networks), observing that the pressures of competition lead to a more rapid pace of innovation, a greater range of price/service choices, and greater discipline over costs and prices. Thus:

> [I]t could be of great magnitude to make substantial sacrifices today in the intensity of competitive market structure in pursuit of the fullest realization of presently available scale economies; the result will quite likely be a significant reduction in the rate at which costs fall as a function of time and changing technology, with the ultimate consequence that future costs will be higher at every level of scale utilization than need have been the case.

Id. at 86

[**] See Fox, excerpts from articles attached.

Introduction

The 1982 Merger Guidelines: When Economists Are Kings?*

Eleanor M. Fox†

I
INTRODUCTION

The Justice Department's 1982 Merger Guidelines[1] signal the second wave in the merger of antitrust law and economics. The first wave was marked by Derek Bok in 1960 with the publication of his article, *Section 7 of the Clayton Act and the Merging of Law and Economics*.[2] The driving force behind the first wave of this movement was law and legal policy. Scholarship of economists was integrated into the law, and economics was used as a tool to implement a policy declared by Congress. The body of economic scholarship upon which Bok drew held that market structure influences conduct, which in turn determines performance, and that concentrated market structures tend to foster noncompetitive performance.[3] The first merger movement may be seen as vertical—the then available economic learning was an input into the law.

Four significant developments catalyzed the second wave of the merger of antitrust law and economics: first, developments in the antitrust case law; second, advances in economic learning; third, changes in the spatial dimensions of competition, with many markets developing transnational characteristics; and fourth, setbacks in the American economy, which helped change the political mood of the country and provoked a call for less government intervention as a cure.[4]

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* "Until philosophers are kings . . . then only will this our State have a possibility of life and behold the light of day." 3 DIALOGUES OF PLATO: THE REPUBLIC 170-71 (B. Jowett trans. 3d ed. 1892).

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[1] U.S. Dep't of Justice, Merger Guidelines, 47 Fed. Reg. 28,493 (1982), *reprinted in* 71 CALIF. L. REV. 649 (1983) [hereinafter cited without cross-reference as Guidelines].

[2] Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226 (1960).

[3] *Id*. at 238-49.

By the end of the 1960's, the case law reflected what many came to regard as the excesses of antitrust. Reflecting a bias against big mergers for social and political reasons, decisions of the Supreme Court invalidated the merger of any significant competitors or pairs of supplier and buyer, even in fragmented markets into which entry was easy, and without regard to any efficiencies that the merger might have promised.[5]

During the same period, several developments in economic thinking occurred. The most dramatic development was the wider acceptance of the view that performance cannot be predicted from market structure. Some economists concluded that, even in highly concentrated markets, firms are as likely as not to perform competitively, and that high profits are more likely to indicate returns from efficiency than exercises of power.[6] Furthermore, some of these economists believe that tacit collusion virtually never exists, while explicit collusion is usually detectable, and therefore a sound merger policy would not be concerned with cartels.[7] The work of most economists, however, continues to confirm a relationship between market power and high concentration in high barrier markets,[8] but many contemporary economists are skeptical of the once accepted wisdom that high concentration necessarily means poor performance.[9] Moreover, economists have devoted continuing attention to firm efficiencies, even those beyond plant scale, that may be realized by merger.[10] In the late 1960's and 1970's their research demonstrated that resource savings from efficiencies can swamp resource losses from price enhancing mergers.[11]

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[4] *See* Fox, *The Modernization of Antitrust: A New Equilibrium*, 66 Cornell L. Rev. 1140, 1140-46 (1981).

[5] *See, e.g.*, United States v. Von's Grocery Co., 384 U.S. 270 (1966); Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

[6] *E.g.*, D. Armentano, Antitrust and Monopoly ch. 2 (1982); Y. Brozen, Concentration, Mergers, and Public Policy (1982) (especially chs. 3 and 6); R. Bork, The Antitrust Paradox chs. 8, 10 (1978); Demsetz, *Two Systems of Belief About Monopoly*, in Industrial Concentration: The New Learning (H. Goldschmid, H. Mann & J. Weston eds. 1974); Peltzman, *The Gains and Losses From Industrial Concentration*, 20 J.L. & Econ. 229 (1977). *See* Edwards, Joffe, Kolasky, McGowan, Mendez-Penate, Ordover, Proger, Soloman & Toepke, *Proposed Revisions of the Justice Department's Merger Guidelines*, 81 Colum. L. Rev. 1543, 1550-51, 1560-64 (1981) [hereinafter cited as Edwards Task Force].

[7] Although this latter proposition goes much further than that documented *supra* at note 6, it is supported by all of the authorities cited there except the Edwards Task Force. However, many economists who believe that "the linkage between concentration and collusion is so complicated and so poorly understood" nevertheless conclude that the dangers of tacit collusion or undetectable express collusion are so significant that the merger law should be designed to deal with them. *See, e.g.*, R. Posner, Antitrust Law 96-97, 111-13 (1976).

[8] *E.g.*, R. Posner, *supra* note 7; F. Scherer, Industrial Market Structure and Economic Performance (2d ed. 1980).

Some economists have focused upon strategies that may be used by leading firms to discipline or destroy rivals, leading to lower output and higher price. See Strategy, Predation, and Antitrust Analysis (S. Salop ed. 1981) (proceedings of staff seminar, FTC Bureau of Economics and Competition, June 5-6, 1980), and Williamson, whose work includes *Predatory Pricing: A Strategic and Welfare Analysis*, 87 Yale L.J. 284 (1977).

[9] *See* Posner, *The Chicago School of Antitrust Analysis*, 127 U. Pa. L. Rev. 925 (1979).

Meanwhile, economic conditions changed. Fiercely efficient foreign competitors eroded the market positions of American producers and contributed to already high levels of unemployment.[12] With inflation and unemployment undermining hopes for a higher standard of living, antitrust law was regarded with suspicion. It was blamed for standing in the way of efficient transactions and preventing American businesses from competing more successfully in domestic and transnational marketplaces.

The election of Ronald Reagan as President in 1980 reflected the changed political mood of the country. Mr. Reagan had promised to restore the economy to its former vigor by getting government out of the business of business.[13] A vision of antitrust as conservative microeconomic policy, which would sanction suit only when it could create a more efficient allocation of resources and thus greater aggregate wealth, fit nicely with the political philosophy and campaign commitment of the Administration.[14]

The second wave of the merger of antitrust law and economics arises in this context. This merger movement has a different character from the first. Its proponents suggest that law and economics are to merge, and that economics is to be the surviving partner. The 1982 Merger Guidelines are symbolic of this second wave. They represent a new positivism; a reduction of legal principles to a simple, unitary, quasi-scientific, outcome-oriented economic model that, in a generalized sense, has been offered as the model for solving all antitrust problems. By embodying only one substantive goal—allocative efficiency—the model offers the appearance of clarity, predictability, and reduced government intervention.

This Symposium explores the 1982 Merger Guidelines from many points of view, and does so on both policy and technical levels. In this Introduction, I first give a brief description of the articles in the Symposium, and then offer some observations about major issues raised by the authors' views and my views of the future of the Guidelines. . . .

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[10] Work regarding efficiencies beyond plant scale relates principally to vertical mergers. *See, e.g.*, Williamson, *Vertical Merger Guidelines: Interpreting the 1982 Reforms*, 71 Calif. L. Rev. 604, 614-15 (1983).

[11] *See, e.g.*, Williamson, *Economics as an Antitrust Defense Revisited*, 125 U. Pa. L. Rev. 699 (1977) [hereinafter cited as Williamson, *Economics Defense Revisited*]; Williamson, *Economics as an Antitrust Defense: The Welfare Tradeoffs*, 58 Am. Econ. Rev. 18 (1968) [hereinafter cited as Williamson, *Economics Defense*].

[12] *See* I. Magaziner & R. Reich, Minding America's Business pt. 1 (1982).

[13] Sheils, Thomas, Abraham & Lubenow, *An Economic Dream in Peril*, Newsweek, Sept. 8, 1980, at 50, 51.

[14] *See* Fox, *supra* note 4, at 1155-57.

APPENDIX
WHAT IS THE QUESTION?

Treatments of merger standards often bypass the basic question: What does it mean for a merger to be "anticompetitive"? There is no one correct answer. The basic question may be stated in several ways. I set forth below options for formulating the question. Each option will include (a); (c) or (d); and (e).

(a) Whether this merger

(b) together with mergers of like-sized firms[115]

(c) (will probably)

[or]

(d) (is likely to create a significant risk or chance of)[116]

(e) confer(ring) on remaining firms in the market power or greater power over output and price

(f) without offsetting resource savings from efficiencies,[117]

(g) or block(ing) the opportunity to dissipate existing power over output and price,[118]

(h) or significantly reduc(ing) chances of innovation[119] or alternatives available to consumers.[120]

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[115] That is, we might consider whether anticompetitive effects are likely if the merging parties merge and similarly situated firms merge. This approach is consistent with the potentiality language of § 7 and a principle of fairness; i.e., if two 7% companies can legally merge today, it may be unacceptable to prevent the next two 7% firms from merging tomorrow. The Supreme Court has adopted this perspective. Brown Shoe Co. v. United States, 370 U.S. 294, 343-44 (1962). Professor Areeda urges the principle as an appropriate policy in view of the fact that a contrary approach provides an incentive to merge early. Areeda, *supra* note 18, at 310.

[116] Whether the anticompetitive effect must be a probable or merely a significant risk can make important differences. For example, if Ford and General Motors were to merge, given the current strength of foreign competition, there is a strong case for the proposition that the merger would not give them power over price. However, there may be a significant risk that the strength of foreign competition may weaken, for economic or political reasons, and that General Motors-Ford would then become the beneficiary of market power.

In a case in which the market was not yet concentrated, the Supreme Court suggested that the probability standard was appropriate. *Brown Shoe*, 370 U.S. at 343. Where concentration was already great, the Supreme Court said that "the importance of . . . preserving the possibility of eventual deconcentration is correspondingly great." United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 365 n.42 (1963).

[117] This clause could also qualify (g), (h), and (i).

[118] *See Philadelphia Nat'l Bank*, 374 U.S. at 365 n.42.

[119] Clause (h) would be relevant only when the market is highly concentrated. It could be significant when potential competition or next best buyer alternatives are a fairly good check on supracompetitive pricing.

As to innovation, see W. BAXTER, P. COOTNER & K. SCOTT, RETAIL BANKING IN THE ELECTRONIC AGE (1977). The authors observe that decreased competition can produce one of two types of social loss. The first type is the static loss associated with reduced output and higher price. "The second type of loss which should be taken into account relates to the pace, over time, at which . . . technology . . . is advanced." *Id.* at 85. Referring to this possible dynamic loss in the context of collaboration between electronic funds transfer systems, the authors state:

(i) or unreasonably exclud(ing) competitors from access on the merits to a scarce or potentially scarce input or a significant share of a market outlet.[121]

"Whether technological advances occur rapidly or only relatively slowly will depend in significant part upon the intensity of rivalry that prevails among suppliers of EFTS services." *Id.*

See also United States v. Aluminum Co. of Am. (Rome Cable), 377 U.S. 271 (1964), in which the Supreme Court invalidated a merger to preserve the independence of a pioneer in the industry.

[120] A purpose of the merger law is to preserve alternatives for consumers. *See Philadelphia Nat'l Bank*, 374 U.S. at 360 n.37, 369-70. This objective is likewise relevant only when the market is highly concentrated.

Actual competition among existing competitors, more than potential competition, may heighten the responsiveness of producers to consumers. Professor Shepherd states:

> *Actual competition in the market . . . is crucial*. It exists and exerts force. In contrast, *potential competition (the possibility that some firm not now in the market will enter at some future time) is usually a secondary and often a trivial matter compared to actual competition*. Entry is a probabilistic thing, of unknown degree, both in its likelihood and in its size. . . .
>
> On the whole, the recent preoccupation of some analysts with entry is a strange effort to replace the heart of the problem with a literally peripheral aspect.

Shepherd, Concepts of Competition and Efficient Policy in the Telecommunications Sector 99, 104 (presented at the Conference on Regulation and the New Telecommunications Networks (June 3, 1982)) (on file with the *California Law Review*) (forthcoming in Telecommunications Today and Tomorrow (E. Noam ed. 1983)) (emphasis in original) (taking issue with the view that, if a market is "contestable," consumers' interests in competition are exhausted). *Cf.* Baumol, *Contestable Markets: An Uprising in the Theory of Industry Structures*, 72 Am. Econ. Rev. 1 (1982) (in some situations potential competition may be a good check against supracompetitive pricing).

Where the market is highly concentrated, the law can appropriately prevent unreasonable elimination of existing alternatives, even though potential competition may arguably constrain price elevation and output restrictions.

Clause (h), like clause (g), would indicate illegality of a General Motors-Ford merger even if such a merger does not produce greater power over output.

[121] The Supreme Court has decided only four vertical and reciprocity merger cases. In all four it found violations, and in all four the finding was based, at least in principal part, on the right of competitors not to be fenced out of any substantial segment of a market, even at a margin, by considerations other than the merits of the product sold. *E.g.*, FTC v. Consolidated Foods Corp., 380 U.S. 592, 594 (1965); Brown Shoe Co. v. United States, 370 U.S. 294, 323-24 (1962); United States v. E.I. du Pont de Nemours & Co. (General Motors), 353 U.S. 586, 603-07 (1957); United States v. Ford Motor Co., 286 F. Supp. 407, 442 (D. Mich. 1968), *aff'd*, 405 U.S. 562, 570-71 (1972).

Apparently, in none of the above cases did defendants gain firm efficiencies as a result of the merger. In *General Motors*, the Court found that duPont used its stock in General Motors to sell more fabrics and finishes to General Motors. 353 U.S. at 606. Consolidated Foods used and attempted to use its buying power to induce its suppliers of processed meat to buy their dehydrated onions and garlic from acquired Gentry. 380 U.S. at 596-97. Ford bought spark plug manufacturing assets of Electric Autolite despite the fact that it could buy spark plugs on the open market at one-third of cost (because sales of plugs to the auto manufacturers for incorporation into the original vehicle gave the plug manufacturers entry into the lucrative after market). 405 U.S. at 565.

A principle based on unreasonable exclusion need not invalidate vertical mergers that are undertaken to realize significant real economies and that do not threaten harm to consumers. Likewise, it should not bar mergers producing de minimis or trivial foreclosure. For an example

Option (a)(c)(e)(f) is the most permissive. It identifies the merger law with allocative efficiency. In addition, and quite separately, it reflects the judgment that the merger law should not be enforced unless it enhances allocative efficiency, as judged from the allocation at the time of the merger. This option is not the only option indicated by a commitment to allocative efficiency. Indeed, (g) would further increase allocative efficiency, and (b), (d), (h) and (i) need not lessen allocative efficiency.[122]

Option (a)(c)(e)(f) is also the option adopted by the Guidelines. Choice of this option, particularly exclusion of (g) combined with the assumption, relevant to (e), that potential competition within a price and time range is as good as actual competition, can profoundly influence market definition and thus antitrust outcomes. To define the market, the Guidelines hypothesize a price increase above *current* price, no matter how concentrated and collusive the market is already.[123]

Option (a)(b)(d)(e)(g)(h)(i) represents the strictest merger enforcement policy within the range presented. This option is supported by the case law.[124]

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of a trivial foreclosure (approximately 1%), see *Brown Shoe*, 370 U.S. at 323-24 (the Court, however, did not then view the foreclosure as trivial).

[122] If it were the case that all mergers are efficient unless they produce output restriction, then a merger policy based on allocative efficiency would reject clauses (b), (d), (h) and (i). However, it is obviously not the case that all such mergers are efficient. Consider, for example, U.S. Steel's acquisition of Marathon Oil Company. *See Du Pont's Unconvincing Merger*, N.Y. Times, Nov. 14, 1982, § 3, at 1, col. 2 (Du Pont-Conoco). *See also* Testimony of F.M. Scherer before the Subcommittee on Monopolies and Commerical Law, Committee on the Judiciary, House of Representatives, Sept. 23, 1981 (on file at the *California Law Review*). That mergers are efficient is not an inference from the evidence; it is an assumption in spite of the evidence. *Id.*

[123] Although the Guidelines do not have a broad efficiencies defense, they have high threshold levels for challenge, apparently so as not to restrict efficiency-creating horizontal mergers. *See* Kauper, *supra* note 24, at 520. As for vertical mergers, the Guidelines indicate great breadth for recognizing efficiencies. *See* Guidelines § IV(B)(1)(c) n.49, 47 Fed. Reg. at 28,501 n.49, 71 CALIF. L. REV. at 664 n.49.

[124] *See supra* notes 1-7.

The new merger guidelines—a blueprint for microeconomic analysis

BY ELEANOR M. FOX*

The following article on the new merger guidelines describes the guidelines for merger analysis issued this summer by the Department of Justice and demonstrates how they work. It compares the Justice Department guidelines with the contemporaneous statement by the Federal Trade Commission on horizontal mergers, with the superseded 1968 Guidelines of the Department of Justice, and with the Supreme Court case law. The author concludes that the new guidelines provide an excellent methodology for analyzing when a merger will give the merging parties a significant increment in the power to raise price above the current market price. She observes that such increased power over current price is one reason but not the only reason why the effect of a merger "may be substantially to lessen competition" within the meaning of the Celler-Kefauver Amendment to section 7 of the Clayton Act.

In appendices, the author provides a historical note on the derivation of the concentration index used in the guidelines, and a table applying the new guideline standards to each Supreme Court case decided under amended section 7 of the Clayton Act.

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IV. The case law

The Supreme Court case law prior to 1974 prohibits mergers of viable, important competitors in concentrated or concentrating markets. The Court declared such mergers illegal, first, "in light of Congress's design in § 7 to prevent undue concentration." Furthermore, the Court believed, "the test is fully consonant with economic theory."[67]

From the late 1950s to the early 1970s, the Court carried out Congress' design to check the trend toward concentration of assets into the hands of "too few" firms, for social and political reasons. It cited the economic authorities that corresponded with this design. Dissenting Justices cited different economists, whose conclusions supported a less interventionist world view. For example, in 1966, Justice Stewart, in his dissenting opinion in *United States v. Von's Grocery Company*, cited Professor Stigler,[68] a prominent economist whose analysis of horizontal mergers in 1955 is close to that reflected in the 1982 Guidelines.[69]

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[67] United States v. Philadelphia National Bank, 374 U.S. 321, 363 (1963). See generally 1 Fox & Fox, Corporate Acquisitions and Mergers, Ch. 8 (1982).

[68] 384 U.S. 270, 281, 303 n.35 (1966).

[69] See Stigler, *Mergers and Preventive Antitrust Policy*, 104 U. Pa. L. Rev. 176, 179-82 (1955).

The Court's opinions reached beyond mergers of competitors that increased market power. The Court held illegal the acquisition of a competitor that was a pioneer in the market, because absorption of this small and vibrant firm removed as an independent an unusually competitive force.[70] It declared illegal acquisitions that slightly increased concentration where concentration was already great, in order to preserve opportunities for deconcentration and thus a more competitive market.[71] It held illegal the acquisition of a major firm in a concentrated market by a major potential entrant, because the potential competitor had a moderating influence on the market.[72] It declared that joint entry by two potential competitors into a highly concentrated market may have been illegal if the joint venturers' independent initiatives would have made the market even more competitive than their joint entry.[73] The Court held acquisition of stock of a major customer illegal because the acquiring supplier got special access to a quarter of the market, although consumers were not hurt.[74] And it held illegal an acquisition that gave the acquirer reciprocity benefits to a quarter of a market, not because consumers were hurt but because competitors were deprived of equal access to compete on the merits for the business of a substantial group of customers.[75]

In the 1970s the Supreme Court refined the potential competition doctrine, and stated the burdens that plaintiffs must meet in such cases.[76] Apart from this refinement, the Supreme Court has never overruled the above precedents.

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[70] United States v. Aluminum Co. of Amer., 377 U.S. 271 (1964).

[71] United States v. Philadelphia National Bank, *supra* note 67, 374 U.S. at 365, n.42: "if concentration is already great, the importance of preventing even slight increases in concentration and so preserving the possibility of eventual deconcentration is correspondingly great" (dictum).

[72] Ford Motor Co. v. United States, 405 U.S. 562 (1972).

[73] United States v. Penn-Olin Chem. Co., 378 U.S. 158 (1964).

[74] United States v. du Pont de Nemours & Co., 353 U.S. 586 (1957) (under unamended 7 of the Clayton Act).

[75] FTC v. Consolidated Foods Corp., 380 U.S. 592 (1965).

Thus, the merger case law goes beyond the single paradigm of the 1982 Guidelines. To explore the differences between the Supreme Court case law and the new guidelines, I have provided, in Appendix B, a comparison based on all Supreme Court cases decided under amended section 7 of the Clayton Act. The comparison yields the conclusion that in 11 of 20 cases in which the Supreme Court found a violation or remanded for fact-finding that might indicate a violation, the current Justice Department would probably not have sued.

The case law may or may not withstand a new look by the Supreme Court in the 1980s.[77] However the case law fares in the face of certain, vigorous challenge, the single-paradigm guidelines are a cogent, important statement of the current policy of the Justice Department, and, as well, a valuable document to guide analysis when the question is: Will this merger probably produce supracompetitive pricing?

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[76] United States v. Marine Bancorporation, 418 U.S. 602 (1974).

[77] Some antitrust decisions by the Burger Court in the mid- to late 1970s indicate that the Court might always ask the economist's question: Does this transaction or practice give defendants the power to raise price above costs? However, a more recent decision (in a maximum price-fixing case) emphasizes that there are other economic concerns of antitrust; that "[c]ompetition, even in a single product, is not cast in a single mold," and that the diversity of competitive response is a value that antitrust protects. See Arizona v. Maricopa County Medical Society, 5 CCH Trade Cas. ¶ 64,792 at 71,897 (Sup. Ct. 1982).

CORPORATE ACQUISITIONS and MERGERS

VOLUME 1

by

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1985

(Date originally published: 1968)

MATTHEW
BENDER
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[t]—Rebutting Plaintiff's Prima Facie Case: Quality of Competition in the Marketplace. As we have seen, plaintiff's proof of high market shares and high concentration may make a *prima facie* case of violation. For many years the inference of violation from a strong statistical case amounted to all but a conclusive presumption, subject to the failing company exception. This is no longer the case. Courts and the Commission are increasingly receptive to nonstatistical proof that the acquisition does not confer or increase market power, and does not otherwise lessen the vitality of competition. The evidence may include a showing of low barriers to entry and many potential competitors or frequent entry,[145] vigorous

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[145] See United States v. Waste Management, Inc., 743 F.2d 976 (2d Cir. 1984); Kaiser Aluminum & Chem. Corp. v. FTC, 652 F.2d 1324 (7th Cir. 1981); United States v. Calmar, Inc., 1985-1 Trade Cas. ¶ 66,588 (D.N.J. 1985); Whittaker Corp. v. Edgar, 535 F. Supp. 933 (N.D. Ill. 1982); FTC v. Great Lakes Chem. Corp., 528 F. Supp. 84 (N.D. Ill.), motion for injunction pending appeal denied (7th Cir. 1981); United States v. Tracinda Investment Corp., 477 F. Supp. 1093 (C.D. Cal. 1979); United States v. Crowell, Collier and Macmillan, Inc., 361 F. Supp. 983 (S.D.N.Y. 1973); *In re* Beatrice Foods Co., 3 Trade Reg. Rep. ¶ 22,035 (FTC 1983) (small scale entry); *In re* Heublein, Inc., 3 Trade Reg. Rep. ¶ 21,763 (FTC 1980); *In re* Pillsbury Co.,

price competition,[146] vigorous foreign competitors competing for the same customers,[147] inability to fix price,[148] declining concentration,[149] lack of competitive significance of the acquired firm,[150] and lack of direct overlap of the merging firms, when they operate in different segments of the market.[151] The evidence may also challenge the predictive value of plaintiff's statistics[152] by showing changes in the market and showing that the market shares attributed to the merging parties overstate their competitive significance.[153]

[1976–1979 Transfer Binder] Trade Reg. Rep. ¶ 21,586 (FTC 1979).

However, relative ease of entry is not likely to save mergers in the higher range of concentration and market share. Actual competition has generally been considered a better check than potential competition. See § 8.02[2][h] *supra.*

[146] See Kaiser Aluminum & Chem. Corp. v. FTC, *supra;* United States v. Crowell, Collier and Macmillan, Inc., *supra In re* Beatrice Foods Co., *supra* (small dairies underprice big firms; no evidence price competition would be suppressed).

[147] See Whittaker Corp. v. Edgar, *supra.*

[148] See Stroh Brewery Co. v. Malmgren, 1982-1 Trade Cas. ¶ 64,670 (W.D. Wis. 1982).

[149] See Kaiser Aluminum & Chem. Corp. v. FTC, *supra;* United States v. International Harvester Co., 564 F.2d 769 (7th Cir. 1977); *In re* Beatrice Foods Co., *supra.* See § 8.02[2][g] *supra.*

[150] See Kaiser Aluminum & Chem. Corp. v. FTC, *supra;* Lektro-Vend Corp. v. Vendo Co., 660 F. 2d 255 (7th Cir. 1981), *cert. denied* 455 U.S. 921 (1982); FTC v. Great Lakes Chem. Corp., *supra.* United States v. M.P.M., Inc., 397 F. Supp. 78 (D. Colo. 1975); *In re* Pillsbury Co., *supra.* See § 8.02[2][n] and [n][iv] *supra* regarding failing and weak firms.

[151] FTC v. Great Lakes Chem. Corp., *supra; In re* Heublein, Inc., *supra.*

[152] United States v. General Dynamics Corp., 415 U.S. 486, 94 S. Ct. 1186, 39 L. Ed.2d 530 (1974).

[153] On the other hand, market factors may indicate that the merger will facilitate cooperative pricing. The existence of many joint arrangements among the major firms, and the fact that the merger is likely to eliminate a destabilizing force, point in this direction. Moreover, high entry barriers and inelastic demand facing the market suggest that the firms have a greater incentive to collude, because there is a larger margin within which colluding firms have power over price. See Marathon Oil Co. v. Mobil Corp., 669 F.2d 378 (6th Cir. 1981), *reaff'd* 669 F.2d 384 (6th Cir.), *cert. denied* 455 U.S. 982 (1982); 1984 Justice Department Merger Guidelines. App. 11A-1 *infra,* 3.

In earlier periods, courts and enforcers seemed unaware that mergers and the freedom to merge might be procompetitive and that a merger law that sweeps too broadly might impose economic costs on society. As the cases cited in this section indicate, this perspective has changed.[154] FTC Commissioner Pitofsky spoke to one part of this issue when he wrote, for the Commission, in *In re Pillsbury Co.:*

> "Long-term competitive considerations require preservation of ease of entry, and opportunity for businessmen to take entrepreneurial risks. The other side of that coin is a largely unarticulated policy, a clear corollary to the first, which would preserve exit opportunities where significant anticompetitive results do not occur. It is essential that the owners of very small businesses with slight competitive potential have some reasonable flexibility to sell out."[155]

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[154] See 1982 Justice Department Merger Guidelines. App. 11A-1 *infra*, 1; Kauper, "The 1982 Horizontal Merger Guidelines: Of Collusion, Efficiency, and Failure," 71 CALIF. L. REV. 497 (1983).

[155] [1976–1979 Transfer Binder] Trade Reg. Rep. ¶ 21,586 (FTC 1979).

The CHAIRMAN. Thank you very much.

Mr. Halverson, we would be glad to hear from you.

STATEMENT OF JAMES T. HALVERSON

Mr. HALVERSON. Mr. Chairman, my name is James T. Halverson. I am appearing today on behalf of the section of Antitrust Law of the American Bar Association, of which I am chairman.

Our remarks have been cleared by blanket authority by the other sections and divisions of the ABA so that we may present them as the views of the section of antitrust law, but they have not yet been approved by the house of delegates or board of governors of the ABA and should not be construed to be the views of the ABA.

The antitrust section very strongly supports the proposed Merger Modernization Act, denoted S. 2160 here in the Senate, as it would codify, as we view them, desirable trends in recent case law, at least the better-reasoned recent case law, and reflect the development of a responsible and respected body of economic analysis.

I will skip through most of my statement, Mr. Chairman, and ask that my statement be placed in the record. Mr. Chairman, my statement will be placed in the record, so I can skip most of it?

The CHAIRMAN. Your entire statement will go in the record in full.

Mr. HALVERSON. Thank you.

The CHAIRMAN. All of your statements will be included; I thought I announced that.

Mr. HALVERSON. With the notable exception of *General Dynamics,* previously mentioned, the Supreme Court of the United States has unfortunately done very little to conform the details of merger antitrust law to contemporary concerns and conditions.

General Dynamics was decided, as indicated, in 1974; that is 12 years ago. Lower courts, confronted with a tension between the Supreme Court's interpretations of the 1960's, which were generally quite hostile to any mergers, and the demands of the modern economy, not surprisingly have developed diverse and sometimes inconsistent approaches to merger antitrust analysis

Some courts have applied currently accepted economic concepts and theories directed toward maximizing consumer welfare, while others appear to be bound to techniques and principles of 20 years ago.

Even among these courts which purport to apply modern economic analysis, a diversity of perspective is apparent, and all these cases are cited in my statement.

The tensions are exacerbated by the lack of a uniform prosecutorial policy. While the Department of Justice and the Federal Trade Commission have disclosed the guidelines that govern their respective decisions to prosecute, private parties actually or prospectively injured by a merger which they claim is unlawful have standing to challenge the acquisition in court.

As a result, as we know, private suits have been initiated against mergers on many different theories not used by the present prosecutorial authorities.

To the extent current interpretations of section 7, whether because of overinclusiveness in fact, diversity of judicial approach or erroneous beliefs in the business community about what is permissible, inhibit efficiency and inhibit efficiency-creating mergers and acquisitions that pose no real threat to competition, the public interest requires that the law should be clarified.

Since the Supreme Court has not, through the common law process, reoriented merger and antitrust analysis in a manner consistent with contemporary concerns, it is the view of the section of antitrust law that the congressional modification of the substantive provision in this law is appropriate.

As far as the direction of change is concerned, with one clarification which we have noted, the proposed Merger Modernization Act strikes a balance between the need to unify merger antitrust law in a manner consistent with today's concerns and the proven usefulness of the common law approach to fine-tuning antitrust policy.

The bill refocuses judicial attention on the consequences of a merger for the exercise of market power, a type of failure that distorts economic efficiency, impedes productivity, inhibits technological advancement, diminishes international competitiveness, and raises consumer prices.

By implication, the bill removes from the purview of the courts other concerns that might diminish the efficiency-producing focus of amended section 7, not because those concerns are necessarily socially undesirable, but rather because the merger antitrust law is an inappropriate instrument to deal with them.

The Merger Modernization Act is textually simple and in line with the broadly phrased language of other substantive provisions of the antitrust laws. It preserves the essential flexibility for the courts to make appropriate adjustments to the administration of merger antitrust law in the future as economic and social conditions change——

The CHAIRMAN. Excuse me just 1 minute.

Senator Grassley, did you have a statement you wanted to put in the record?

Senator GRASSLEY. No, but I have——

The CHAIRMAN. I understand you have got to leave. Did you have a statement you wanted to put in the record?

Senator GRASSLEY. No, but I will submit some questions.

The CHAIRMAN. All right.

If you will kindly answer the questions Senator Grassley has, he has another engagement and has to leave.

Mr. HALVERSON. Yes, sir.

The CHAIRMAN. You may proceed.

Mr. HALVERSON. The proposal, as I said, preserves essential flexibility for the courts to make appropriate adjustments in the administration of merger antitrust law in the future as economic and social conditions change and as economic theory develops a better understanding.

The one modification the antitrust section would propose is to keep the reasonable probability standard and not adopt the proposed significant probability standard, since the former standard has been well developed consistently from the 1960's, through the 1970's, and into the 1980's.

Otherwise, Mr. Chairman, we strongly support enactment of the proposed act.

[The prepared statement follows:]

STATEMENT OF JAMES T. HALVERSON

ON BEHALF OF THE SECTION OF ANTITRUST LAW OF THE AMERICAN BAR ASSOCIATION

BEFORE THE COMMITTEE ON THE JUDICIARY UNITED STATES SENATE

REGARDING S. 2160 THE MERGER MODERNIZATION ACT OF 1986

MAY 12, 1986

Mr. Chairman and members of the Committee, my name is James T. Halverson, and I am appearing today on behalf of the Section of Antitrust Law of the American Bar Association. My remarks represent the views of the Section of Antitrust Law only. They have not been approved by the House of Delegates or the Board of Governors of the ABA, and should not be construed to be the views of the ABA. They have, however, received Blanket Authority clearance from the other Sections and Divisions of the ABA to be presented as the views of the Section of Antitrust Law.

In general, the Section supports the proposed Merger Modernization Act, denoted S. 2160 here in the Senate, as it would codify desirable trends in the recent case law and reflect the development of a responsible and respected body of economic analysis. My full statement, which constitutes the report of the Section on the bill, outlines the Section's position in some detail.

Introduction

The Merger Modernization Act of 1986 is proposed by the Reagan Administration to modernize the merger law and codify over a decade of merger enforcement policy learning and recent enforcement practice.[1] If enacted, the Merger Modernization Act would amend Section 7 of the Clayton Act[2] to clarify the standards by which to judge the antitrust propriety of mergers and acquisitions. The Section of Antitrust Law of the American Bar Association believes that the proposed bill incorporates responsible economic analysis and that it codifies sound merger enforcement policy. The Section supports the legislation (with one important clarification, discussed below) and urges its enactment.[3]

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[1] The Merger Modernization Act of 1986 was introduced in the House of Representatives as H.R. 4247 on February 26, 1986. An identical bill, S. 2160, was introduced in the Senate on March 7, 1986. S. 2280 Cong. Rec. (March 7, 1986).

[2] 15 U.S.C. § 18 (1982).

[3] As amended, the first paragraph of Section 7 would read as follows:

> [N]o person engaged in commerce or any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the

[footnote continued on next page]

A. The Proposed Amendment

The Justice Department's analysis accompanying the Merger Modernization Act states that its purpose is to "incorporate the advances in merger learning that have been made during the last twenty years . . . [and] provide a new state-of-the-art foundation upon which future refinements and improvements can be built, while at the same time finally laying to rest outmoded economic and legal analysis of mergers that can be found in older court decisions."[4] The Administration's proposed legislation seeks to achieve this goal by three modifications to Section 7 of the Clayton Act.

First, the bill would rewrite the so-called "incipiency" standard of Section 7 to eliminate ambiguity the Administration perceives in the existing wording of the statutory test and to bring the language of the statute explicitly in line with accepted economic principles, current government enforcement policies, and what are accepted as the better-reasoned judicial and FTC interpretations of Section 7.

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[3] [footnote continued from previous page]

> jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, there is a significant probability that such acquisition will substantially increase the ability to exercise market power, or tend to create a monopoly.

Conforming modifications would be made to the second paragraph.

[4] U.S. Dep't of Justice, "Merger Modernization Act of 1986"--Analysis 4 (February 19, 1986).

As currently worded, the Clayton Act prohibits any merger or acquisition where the effect of the transaction "may be substantially to lessen competition or to tend to create a monopoly" in any relevant antitrust market. The Merger Modernization Act would replace the somewhat vague, subjective standard embodied in the use of the words "may be" and "tend to" with the more precise requirement that the acquisition entail a "significant probability" that the requisite anticompetitive effect will result in fact if the transaction is consummated. The Administration submits that this change in the wording of the incipiency standard lessens the ambiguity inherent in the existing language and accurately reflects current case law.

Second, the bill seeks to refocus and clarify the nature of the competitive impact inquiry mandated by Section 7. As currently written, Section 7 contains two alternative tests of proscribed effect--the lessening of competition and the creation of a monopoly. While taking no issue with the latter test, the Administration contends that the less stringent "lessening competition" test provides insufficient indication of what the antitrust merger laws should be designed to prevent. The Administration argues that Section 7 of the Clayton Act, and all other provisions of the antitrust laws, should be directed against conduct that threatens to enable firms in the marketplace to charge prices to consumers that are above competitve levels. To capture this particular notion of anticompetitive effect, and to exclude the courts from considering as anticompetitive other types of consequences that may flow from given mergers and acquisitions, the Administration's proposal would replace the words "lessen competition" in the existing Section 7 test with the words "increase the ability to exercise market power." The bill also would add to Section 7 a definition of "market power"--"the ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time"--thus reemphasizing that the purpose of Section 7 is to protect consumers from anticompetitive price increases.

Third, the bill seeks to provide guidance as to the factors that might indicate whether a given acquisition creates or facilitates the exercise of market power. If enacted, the bill would instruct the courts when applying the amended Section 7 to

> consider all economic factors relevant to the effect of the acquisition in the affected markets, including (i) the number and size distribution of firms and the effect of the acquisition thereon; (ii) ease or difficulty of entry by foreign or domestic firms; (iii) the ability of smaller firms in the market to increase production in response to an attempt to exercise market power; (iv) the nature of the product and terms of sales; (v) conduct of firms in the market; (vi) efficiencies deriving from the acquisition; and (vii) any other evidence indicating whether the acquisition will or will not substantially increase the ability, unilaterally or collectively, to exercise market power.

By listing six factors that the courts should take into account in evaluating every merger and acquisition, the bill is intended to provide a sound organizing framework for the identification and collection of evidence most likely to be probative of a given transaction's market power consequences. At the same time, by including a saving provision as the seventh factor, the bill makes clear that the enumeration is not intended to be exhaustive, and that courts should take into account all evidence probative of a transaction's implications for the exercise of market power.

B. The Need for Change

Substantive amendments to the antitrust laws should not be taken lightly. Since the passage of the Sherman Act in 1890, Congress only rarely has intervened to modify the substantive provisions of the antitrust statutes. Rather, recognizing the wide diversity and ever-changing nature of business conduct, Congress wisely has adopted antitrust provisions that are broadly phrased and for the most part has depended on the courts to tailor the details of the law to the demands of the day.[5] This common law approach to antitrust policy has served the Nation well in the past, and therefore proponents of statutory change should bear the burden of proof in making their case.

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[5] As Senator Sherman himself recognized:

> I admit that it is difficult to define in legal language the precise line between lawful and unlawful combinations. This must be left for the courts to determine in each particular case. All that we, as lawmakers, can do is to declare general principles, and we can be assured that the courts will apply them so as to carry out the meaning of the law . . . .

21 Cong. Rec. 2460 (1890). See also National Soc'y of Professional Engr's v. United States, 435 U.S. 679, 688 (1978) ("Congress . . . did not intend the text of the Sherman Act to delineate the full meaning of the statute or its application in concrete situations. The legislative history makes it perfectly clear that it expected the courts to give shape to the statute's broad mandate by drawing on common law tradition.") (footnote omitted).

Section 7 itself has been the subject of only one significant amendment since the passage of the original Clayton Act in 1914. The original Section 7 prohibited only stock acquisitions by corporations and then only when the effect of the acquisition "may be to substantially lessen competition between the [two] corporation[s] . . . or to restrain such commerce in any section or community, or tend to create a monopoly of any line of commerce."[6] In 1950, in the Celler-Kefauver Amendment, Congress amended Section 7 to expand its coverage to asset as well as stock acquisitions, and to revise the formulation of the proscribed competitive impact to ensure that the section reached vertical and conglomerate acquisitions as well as horizontal acquisitions.[7]

Passage of the Celler-Kefauver Amendment was a reaction to the failure of the courts to interpret Section 7 in a manner consistent with the concerns of the post-World War II period. Substantial concern over the perceived increase in industrial concentration, the loss of opportunity to the small businessman, and the decline of local control over business, coupled with skepticism that significant productive efficiencies ever accompanied large mergers and acquisitions, pointed to a strict policy of merger antitrust enforcement. The courts, in keeping with an earlier belief (carried forward in precedent) that substantial economies often did result from ownership integration, and a continuing respect for the sanctity of contracts for the purchase and sale of private property, pursued a much more lenient approach to merger antitrust legality. Passage of the Celler-Kefauver Amendment served to redirect the courts to adopt a more stringent attitude toward mergers and acquisitions without waiting for this development through the much more gradual process of common law refinement.[8]

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[6] Clayton Act § 7, ch. 323, 38 Stat. 730, 731-32 (1914).

[7] Ch. 1184, 64 Stat. 1125 (1950). The only other revision was made by the Antitrust Procedural Improvements Act of 1980, which extended the subject matter jurisdiction of Section 7 to any "person," not just corporations, "affecting," and not only those strictly "in," commerce. Pub. L. No. 96-349, 94 Stat. 1154 (1980).

The merger decisions of the 1960's which followed the Amendment can be criticized in that they instituted a policy of looking quickly at a merger and determining with little analysis that market structure was inevitably linked to market performance. In addition, it focused attention on social policies not necessarily consistent with economic principles and consumer welfare, notwithstanding the fact that the legislative history of the 1950 Amendment makes clear that the competitive consequences of mergers were to be analyzed in economic terms.

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[8] Notably, the impetus for judicial change came not so much from the language of the Celler-Kefauver Amendments, which made only simple modifications to Section 7 directed primarily to matters of subject matter juridiction, but rather from the legislative history. See Brown Shoe Co. v. United States, 370 U.S. 294, 312 (1962).

Today, however, the promotion of economic efficiency and consumer welfare has assumed a prominence among the Nation's objectives unlike any time in the past. In the post-World War II expansion, concerns about promoting economic efficiency were secondary, if not almost irrelevant. The period surrounding the passage of the Celler-Kefauver Amendment exhibited enormous economic growth, technological innovation, rising productivity, and low inflation. The United States became the unquestioned leader in economic and business affairs internationally and experienced a substantial trade surplus in merchandise. Impediments to economic efficiency arising from antitrust law constraints were simply lost in the noise of the economic expansion. Beginning in the early 1970's, however, the American economic picture began to darken. Productivity dropped, inflation increased, the trade surplus turned into a deficit, and the relative technological edge of the United States over its foreign competitors diminished.

As the Nation gradually realized that these adverse changes were not transitory, increasing effort was devoted to revitalizing American business and regaining our international competitiveness. One cost imposed on American business that foreign companies did not face (at least not to the same extent) was the cost of government regulation, including regulation imposed by the antitrust laws. While in many instances the benefits of regulation--in such areas as the environment, occupational health and safety, and competition--clearly exceeded their costs, in other cases regulations had evolved for which there was no demonstrable net social benefit. As part of the effort to revitalize American business, Congress, the regulatory agencies, and the courts have attempted to adjust government interference in the marketplace to ensure that only interventions that produce demonstrable net social benefits remain in place.

Consistent with the common law approach to antitrust policy, the Supreme Court has made a number of contributions to ensure that the constraints imposed by the antitrust laws do not entail social costs in excess of the benefits they produce. In 1974, for example, the Supreme Court in General Dynamics made clear that the presumption of a merger's probable anticompetitive effect drawn from high concentration and the distribution of market shares--a presumption that in practice did more to prevent increases in industrial concentration than to ensure economic efficiency--was rebuttable upon a showing that the proferred evidence was not in the circumstances of the case a reliable indicator of future competitive effect.[9] Several years later, in GTE Sylvania, the Court overruled an earlier opinion holding non-price distributional restrictions to be per se unlawful and held instead that the antitrust legality of these restraints was to be judged under the rule of reason.[10] In particular, the Court held that in light of the potential economic efficiencies that non-price vertical restraints may entail, to be unlawful these types of restraints must be shown to be anticompetitive on a case-by-case basis in the particular commercial circumstances in which they are employed.[11] Even horizontal arrangements have not been immune from the Court's efforts to permit efficiency-enhancing arrangements provided that competition is not injured. In 1979, the Court held in Broadcast Music that a combination of horizontal competitors in the blanket licensing of musical compositions and pooling of blanket license fees--an arrangement that by analogy to past precedent should have been per se unlawful--was to be examined under the rule of reason where the defendants had presented substantial evidence that the clearinghouse was necessary to the creation and marketing of the members' products.[12] More recently, the Court has emphasized that the antitrust laws protect competition in order to enhance consumer welfare,[13] and that under the rule of reason business practices should be suspect only to the extent they tend to increase consumer prices or reduce output.[14] Other recent examples of the Court's efforts to focus antitrust legal theory on the efficiency implications of business conduct in order to promote consumer welfare may be found in the areas of predatory pricing,[15] tying arrangements,[16] group boycotts,[17] and the intraenterprise conspiracy doctrine.[18]

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[9] United States v. General Dynamics, 415 U.S. 486 (1974). The presumption was first formally recognized by the Court in 1963 in United States v. Philadelphia National Bank, 374 U.S. 321 (1963), and soon became read by the lower courts as virtually conclusive.

[10] Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977), overruling United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

[11] 433 U.S. at 54.

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[12] Broadcast Music, Inc. v. CBS, 441 U.S. 1 (1979).

[13] See Reiter v. Sonotone Corp., 442 U.S. 330, 343 (1979) ("Congress designed the antitrust laws as a 'consumer welfare prescription,'" citing R. Bork, The Antitrust Paradox 66 (1978)); accord, NCAA v. Board of Regents of the University of Oklahoma, 104 S.Ct. 2948, 2963-4 (1984).

[14] See NCAA v. Board of Regents of the University of Oklahoma, 104 S.Ct. 2948, 2960-64 (1984).

[15] See Matsushita Electric Industrial Co., Ltd. v. Zenith Radio Corp., 54 U.S.L.W. 3609 (Mar. 18, 1986).

[16] See Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2 (1984).

[17] See Northwest Wholesale Stationers, Inc. v. Pacific Stationery and Printing Co., 105 S.Ct. 2613 (1985).

[18] See Copperweld Corp. v. Independence Tube Corp., 104 S.Ct. 2731 (1984).

With the notable exception of General Dynamics, decided twelve years ago, the Supreme Court has done very little to conform the details of merger antitrust law to contemporary concerns and conditions.[19] Lower courts, confronted with a tension between the Supreme Court's interpretations of the 1960's and the demands of the modern economy, not surprisingly have developed diverse and sometimes inconsistent approaches to merger antitrust analysis. Some courts have applied currently accepted economic concepts and theories directed toward maximizing consumer welfare, while others appear more bound to techniques and principles of twenty years ago.[20] Even among those courts which purport to apply modern economic analysis, a diversity of perspective is apparent.[21]

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[19] In recent years, the Court has accepted only one merger case. Cargill, Inc. v. Monfort of Colorado, pet. for cert. granted, 106 S.Ct. 784 (1986). This case, which most likely will be heard by the Court in the coming 1986 Term, could easily be decided on the issue of standing without addressing substantive merger standards.

[20] Compare, e.g., Tenneco, Inc. v. FTC, 689 F.2d 346 (2d Cir. 1982), and Fruehauf Corp. v. FTC, 603 F.2d 345 (2d Cir. 1979), with Marathon Oil Corp. v. Mobil Oil Corp., 669 F.2d 384 (6th Cir. 1982), and Mississippi River Corp. v. FTC, 454 F.2d 1083 (8th Cir. 1972).

[21] Compare, e.g., White Consolidated Industries, Inc. v. Whirlpool Corp., 612 F.Supp. 1009 (N.D. Ohio), preliminary injunction vacated, 619 F.Supp. 1022 (N.D. Ohio 1985), aff'd, 781 F.2d 1224 (6th Cir. 1986), with Monfort of Colorado v. Cargill, Inc., supra n. 21.

The tensions are exacerbated by the lack of a uniform prosecutorial policy. While the Department of Justice and the Federal Trade Commission have disclosed the guidelines that govern their respective decisions to prosecute,[22] private parties actually or prospectively injured by a merger they claim is unlawful have standing to challenge the acquisition in court. As a result, private suits have been initiated against mergers and acquisitions that the government has elected not to challenge.[23]

To the extent that the current interpretations of Section 7--whether because of overinclusiveness in fact, diversity of judicial approach, or erroneous beliefs in the business community about what is permissible--inhibit efficiency-creating mergers and acquisitions that pose no real threat to competition, the public interest requires that the law should be clarified. Since, for whatever reasons, the Supreme Court has not through the common law process reoriented merger antitrust law in a manner consistent with contemporary concerns, it is the view of the Section of Antitrust Law that this is one of the rare instances where congressional modification of a substantive provision of the law is appropriate.

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[22] U.S. Dep't of Justice, Merger Guidelines (rev. 1984), reprinted in 49 Fed. Reg. 26,823 (1984); Fed. Trade Comm'n, Statement Concerning Horizontal Mergers (June 14, 1982), reprinted in 2 Trade Reg. Rep. (CCH) ¶ 4516.

[23] See, e.g., White Consolidated Industries, Inc. v. Whirlpool Corp., 612 F.Supp. 1009 (N.D. Ohio), preliminary injunction vacated, 619 F.Supp. 1022 (N.D. Ohio 1985), aff'd, 781 F.2d 1224 (6th Cir. 1986); Monfort of Colorado v. Cargill, Inc., 761 F.2d 570 (10th Cir. 1985), pet. for cert. granted, 106 S.Ct. 784 (1986); G. Heileman v. Christian Schmidt Brewing Co., 753 F.2d 1354 (6th Cir. 1985). The question of private standing to sue for violations of Section 7 has recently become a much debated issue. The question of competitor standing is now pending before the Supreme Court in Monfort, while the question of target company standing will be reargued soon before the full Third Circuit in H.H. Robertson v. Guardian Industries, 1986-1 Trade Cases (CCH) ¶ 66,911 (3d Cir. 1986), vacated and rehearing en banc granted, 50 Antitrust & Trade Reg. Rep. (BNA) 313 (Feb. 20, 1986).

C. The Direction of Needed Change

The proposed Merger Modernization Act, with one important clarification explained below, strikes a balance between the need to unify merger antitrust law in a manner consistent with today's concerns and the proven usefulness of the common law approach to finetuning antitrust policy. The bill refocuses judicial attention on the consequences of a merger for the exercise of market power, a type of market failure that distorts economic efficiency, impedes productivity, inhibits technological advancement, diminishes the international competitiveness of American business, and raises consumer prices. By implication, the bill removes from the purview of the courts other concerns that might diminish the efficiency-promoting focus of the amended Section 7, not because those concerns are necessarily socially undesirable but rather because the merger antitrust law is an inappropriate instrument to deal with them. The Merger Modernization Act is textually simple and in line with the broadly phrased language of the other substantive provisions of the antitrust laws. It preserves the essential flexibility of the courts to make appropriate adjustments in the administration of merger antitrust law in the future as economic and social conditions change and as economic theory develops a better understanding of why firms engage in mergers and acquisitions and the competitive consequences of their behavior.

The one modification the Section proposes is to change the threshold likelihood of the proscribed anticompetitive effect from a "significant probability" to a "reasonable probability." The Administration's proposal, which is designed to codify existing case law, would inject unnecessary confusion, and perhaps result in an inadvertent modification of the current standard. The Supreme Court in construing the incipiency standard has used the words "reasonable probability," and the Section of Antitrust Law believes that the simple incorporation of this judicial phrase with the appropriate supporting legislative history would eliminate any inadvertent tension between the case law and the codification, thereby fulfilling the Administration's intent while preventing unnecessary uncertainty.

1. The incipiency standard

Since its original enactment in 1914, the Clayton Act has used the words "may be" and "tend to" to indicate that the statute's prohibition was triggered on the threat, rather than the realization, of the proscribed anticompetitive effect.[24] In construing the original language of Section 7 in United States v. E.I. duPont de Nemours & Co.,[25] the Supreme Court observed:

> Section 7 is designed to arrest in its incipiency not only the substantial lessening of competition from the acquisition by one corporation of the whole or any part of the stock of a competing corporation, but also to arrest in their incipiency restraints or monopolies in a relevant market which, as a reasonable probability, appear at the time of suit likely to result from the acquisition by one corporation of all or any part of the stock of any other corporation. The section is violated whether or not actual restraints or monopolies, or the substantial lessening of competition, have occurred or are intended.[26]

While Section 7 does not require a finding that the merger in question would have definite anticompetitive consequences, it does require more than the mere possibility of a prohibited restraint. The Supreme Court has emphasized that Section 7 is concerned with the loss of competition "which is sufficiently probable and imminent,"[27] not with "ephemeral possibilities" that may or may not occur.[28] The Court's repeated articulation of the requisite showing is that of a "reasonable probability" that the merger if consummated would substantially lessen competition or tend to create a monopoly.[29]

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[24] See, e.g., 51 Cong. Rec. 14463-64 (Aug. 31, 1914) (accepting without objection during Senate floor debate substitution of the words "may be" for the word "is").

[25] 353 U.S. 586 (1957).

[26] Id. at 589.

An inadequacy in the Court's formulation, however, and perhaps the reason for the Administration's particular choice of words in its proposed bill, is the failure to specify the standard against which the reasonableness of the likelihood of the anticompetitive effect is to be judged. The Administration's proposal requires a "significant probability" that the anticompetitive effect will occur in fact. The use of the word "significant" suggests, perhaps inadvertently, an inflexible, quantitative standard to be applied to all mergers and acquisitions regardless of the surrounding circumstances. We respectfully submit that this interpretation is at odds with the express purpose of the Administration's proposal, which is to codify better-reasoned judicial standards and current enforcement practice. Moreover, the contrast between the use of the term "significant" in the legislation and the use of the term "reasonable" by the Supreme Court almost inevitably will lead to confusion before the courts as to whether Congress intended the threshold probability to be higher than a "reasonable" one. Finally, use of the term "significant" does not go that far in eliminating uncertainty over the reach of the incipiency standard; intelligently conveying a quantitative standard of probability over future events is problematic at best.

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[27] United States v. Continental Can Co., 378 U.S. 441, 458 (1964).

[28] United States v. Marine Bancorporation, 418 U.S. 602, 622-23 (1974), citing Brown Shoe Co. v. United States, 370 U.S. 294, 323 (1962).

[29] See FTC v. Procter & Gamble Co., 386 U.S. 568, 577 (1967); FTC v. Consolidated Foods Corp., 380 U.S. 592, 600 (1965); United States v. Penn-Olin Chem. Co., 378 U.S. 158, 175-76 (1964); United States v. Aluminum Co. of America, 377 U.S. 271, 280 (1964); United States v. El Paso Natural Gas Co., 376 U.S. 651, 658 (1964); Brown Shoe Co. v. United States, 370 U.S. 294, 323 (1962). [Note that these cases are cited only for their development of the term "reasonable probability."]

The Section of Antitrust Law believes that the better approach would be to adopt the language of the Supreme Court. Doing so would have three beneficial results: first, the standard would be flexible in its application, as demonstrated by the history of courts' use of the term "reasonable probability"; second, the statutory use of the same term which has been developed by the courts would lend continuity to merger analysis; and third, there would therefore be less tension between the recognized judicial standard and the standard codified into the amended statute.

2. The test of anticompetitive effect

The Section of Antitrust Law supports the change in the test of anticompetitive effect proposed by the Merger

Modernization Act. By directing the attention of the courts to the effects of a merger on the ability to exercise market power, rather than the present statute's more amorphous standard of lessening of competition, Congress will ensure that the courts uniformly interpret Section 7 in terms of promoting economic efficiency, thereby assisting in the revitalization of American industry. This amendment also will remove substantial uncertainty in the business community as to the standard of merger antitrust legality applied by the courts in reviewing both government and private merger challenges.

Since 1950, Section 7 has been the primary enforcement vehicle for challenging mergers thought to be anticompetitive. For the first twenty years of merger enforcement following the passage of the Celler-Kefauver Amendment, judicial decisions tended to focus their competitive analysis primarily on concentration levels, trends toward concentration, and the resulting market share percentage to be held by the surviving firm within the relevant markets in which the merging parties participate. In effect, market share analysis became an evidentiary surrogate for more complete economic evidence bearing on the likely competitive effects of a given merger. In 1963, the Supreme Court gave its approval to this approach in United States v. Philadelphia National Bank:[10]

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[10] 374 U.S. 321 (1963).

> Congressional concern with the trend toward concentration warrants dispensing, in certain cases, with elaborate proof of market structure, market behavior, or probable anticompetitive effects. Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.[31]

The traditional structuralist approach epitomized in Philadelphia Bank held sway during the balance of the 1960's and into the 1970's. In 1974, however, the Supreme Court in United States v. General Dynamics Corp.[32] upheld a lower court determination that a merger of two coal producers would not substantially lessen competition within the meaning of Section 7, despite market share statistics apparently meeting the "presumptive illegality" standard of Philadelphia Bank. By focusing on the uncommitted coal reserves as distinct from current production, the Court found that the acquired entity was unlikely to remain as significant a market factor as its market share in current production would suggest. While General Dynamics did not overrule Philadelphia Bank, it did make clear that the presumption of anticompetitive effect commonly drawn from limited structural evidence was rebuttable, not conclusive. Subsequent lower court and FTC merger decisions have viewed General Dynamics as a point of departure for looking beyond market share and concentration levels to more particularized economic evidence bearing on competitive effect, resulting in more informed and better decisions. For example, recent decisions have focused on such questions as existence of entry barriers in a given market;[13] efficiencies to be achieved as a result of given acquisition;[14] and whether potential entry by new firms, or expanded entry by existing firms might prevent exercise of market power.[15]

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[31] Id. at 363.

[32] 415 U.S. 486 (1974).

The increased sophistication in adjudicative use of economic analysis is paralleled both by recent enforcement policy initiatives and by an enriched scholarly debate in the area of industrial organization economics. Thus the Justice Department's 1982 Merger Guidelines articulated a "unifying theme . . . that mergers should not be permitted to create or enhance 'market power' or to facilitate its exercise."[36] The DOJ Guidelines define "market power" as the ". . . ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time. . . ."[37] The Guidelines declare: "A variety of factors other than concentration, market shares, and ease of entry affect the likelihood that a merger will create, enhance or facilitate the exercise of market power."[38] This enforcement approach was reiterated and embellished in Revised Guidelines issued in June 1984.[39] The Federal Trade Commission, too, issued a policy statement in 1982 relating to horizontal merger enforcement observing that ". . . recent empirical economic research and well over a decade of practical experience . . . have led the Commission to conclude that proper consideration of market realties justifies . . . greater consideration of evidence beyond mere market shares when such evidence is available and in reliable form."[40]

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[13] See, e.g., United States v. Waste Management, Inc., 743 F.2d 976 (2d Cir. 1984); United States v. Calmar, Inc., 612 F. Supp. 1298 (D.N.J. 1985); The Echlin Mfg. Co., 3 Trade Reg. Rep. (CCH) ¶ 22,268 (FTC 1985); Hospital Corp. of America, 3 Trade Reg. Rep. (CCH) ¶ 22,301 (FTC 1985).

[14] See, e.g., American Medical International, Inc., 3 Trade Reg. Rep. (CCH) ¶ 22,170 (1984), mod., 3 Trade Reg. Rep. (CCH) ¶ 22,209 (FTC 1984); FTC acceptance of GM/Toyota consent order, 103 F.T.C. 374 (1985); Hospital Corp. of America, supra.

[15] See, e.g., United States v. Waste Management, Inc., 743 F.2d 976 (2d Cir. 1984); United States v. Calmar, Inc., 612 F. Supp. 1298 (D.N.J. 1985); The Echlin Mfg. Co., 3 Trade Reg. Rep. (CCH) ¶ 22,268 (FTC 1985).

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[36] U.S. Dep't of Justice, Merger Guidelines 2 (1982), 47 Fed. Reg. 28,493 (1982), revised, 49 Fed. Reg. 26,823 (1984).

[37] Id. at 3.

[38] Id. at 23 et seq. In addition to ease of entry and basic structural statistics, the Guidelines reference each additional "economic factor" set forth in the Merger Modernization Act.

[39] U.S. Dep't of Justice, Merger Guidelines (June 14, 1984), 49 Fed. Reg. 26,823 (1984).

Growth in the academic debate over an appropriate analytic framework for merger analysis has accompanied--and reinforced--these trends in enforcement policy and the case law. In the early years following passage of the Celler-Kefauver Amendment, industrial organization economists preponderantly supported a structure-conduct-performance model which viewed market power and excess profits varying directly with concentration in a given market.[41] This view--supportive of a "presumptive illegality" approach such as that of Philadelphia Bank--has since been challenged by a school of thought which holds most mergers are efficiency-enhancing and that the appropriate analytic framework is one which focuses on the likelihood a merger would permit the exercise of market power.[42] By the late 1970's there was substantial discontent over the adequacy of the market structure model. Empirical studies had cast doubt on the relationship between concentration and excess profits, one of the mainstays of the economic theory underlying the market structure approach. Barriers to entry, another critical element, were discovered to be much more complex phenomena than originally thought, calling into question some of the antitrust concepts, such as entrenchment, that were derived from the original formulation. Further theoretical investigations into the notions of economies of scale and scope, particularly in the multi-plant firm, revealed efficiencies that had formerly been discounted or ignored. Finally, recent work has suggested that transactions costs may be fundamental in understanding economic efficiency and its relationship to promoting consumer welfare.[43]

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[40] Fed. Trade Comm'n, Statement Concerning Horizontal Mergers (June 14, 1982), reprinted in 2 Trade Reg. Rep. (CCH) ¶ 4516.

[41] See, e.g., J.Bain, Industrial Organization (1st ed. 1959); F. Scherer, Industrial Market Structure and Economic Performance (1st ed. 1970); Bok, Section 7 of the Clayton Act and the Merging of Law and Economics, 74 Harv. L. Rev. 226 at 321 (1960).

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[42] See, e.g., Bork & Bowman, The Crisis in Antitrust, 65 Colum. L. Rev. 363 (1965); Brozen, Concentration and Structural and Market Disequilibria, 16 Antitrust Bull. 241 (1971); Demsetz, Industry Structure, Market Rivalry, and Public Policy, 16 J.L. & Econ. 1 (1973).

[43] Much of this debate is summarized in J. Halverson and E. Fox, eds., Antitrust Policy in Transition: The Convergence of Law and Economics (1984).

In retrospect, the common law refinement of merger antitrust law has not kept pace with changes in modern conditions and concerns, particularly the need to revitalize American business, and with new developments in our understanding of industrial organization behavior and its consequences. Enactment of the effects test of the Merger Modernization Act would free judicial interpretation from much of the outmoded precedent of the past and enable the courts to give immediate recognition to the pressing economic concerns of today. At the same time, the wording of the effects test preserves the basic common law framework for future judicial development of merger antitrust law.

a. Codification of Specific Consensus Economic Factors

In order to codify use of basic economic learning which has been developing throughout the period following the Celler-Kefauver Amendment, and particularly since the mid-1970's, S. 2160 would incorporate six specific factors to be considered by the courts in determining whether a given acquisition creates or facilitates the exercise of market power. As mentioned supra, these factors are:

(1) the number and size distribution of firms and the effect of the acquisition thereon;

(2) ease or difficulty of entry by foreign or domestic firms;

(3) the ability of smaller firms in the market to increase production in response to an attempt to exercise market power;

(4) the nature of the product and terms of sales;

(5) conduct of firms in the market; and

(6) efficiencies deriving from the acquisition.

In addition, the courts would consider "any other evidence indicating whether the acquisition will or will not substantially increase the ability, unilaterally or collectively, to exercise market power," so the list is not exclusive.

The six specifically enumerated factors closely parallel specific factors listed in the 1984 Merger Guidelines at §§ 3.3, 3.4 and 3.5. They represent not only the Department of Justice's determination of the proper factors to be applied, but are in effect factors which have been embraced by a consensus of economists and antitrust commentators as indicative of the future effects of a given merger. A recent case stated:

> Assessment of an acquisition's competitive significance begins with consideration of the degree of industry concentration and of the market shares of the combining firms, and proceeds from there to a review of qualitative factors to determine whether the acquisition poses a "significant threat to competition." United States v. General Dynamics Corp., 415 U.S. 486 (1974); Department of Justice Merger Guidelines -- (1982) [citations omitted]; Statement of the Federal Trade Commission Concerning Horizontal Mergers [citations omitted] (June 17, 1982); see Kaiser Aluminum & Chemical Corp. v. FTC, 652 F.2d 1324 (7th Cir. 1981). Among the qualitative factors most important to such an analysis are the difficulty of entry into the market and other market characteristics that may be conducive to interdependent or non-competitive behavior. FTC Statement, supra. See also R. Posner, Antitrust Law: An Economic Perspective 55-61 (1976).[44]

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[44] FTC v. Bass Brothers Enterprises, Inc., 1984-1 Trade Cas. (CCH) ¶ 66,041 (N.D. Ohio 1984) at 68,620.

The first factor, the number and size distribution of firms and the effect of the acquisition thereon, of course embraces the traditional market share analysis which has always been a part of merger law and which is incorporated in the current Guidelines' Herfindahl-Hirschman Index calculation. Antitrust experts would agree that market share analysis has a significant bearing on the evaluation of a merger.[45]

The second factor, ease or difficulty of entry by foreign or domestic firms, is also considered critical by many authorities. It is discussed in the Merger Guidelines at § 3.23, which discusses Special Factors Affecting Foreign Firms, and § 3.3, which discusses Ease of Entry generally. While some authors question the existence of true barriers to entry,[46] most consider them highly relevant to merger analysis.[47]

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[45] See, e.g., 4 P. Areeda and D. Turner, Antitrust Law ¶ 908 et seq. (1980); R. Bork, The Antitrust Paradox, 221-2 (1978); R. Posner, Antitrust Law 109-112 (1976).

[46] R. Posner, supra n. 47, at 92; R. Bork, supra n. 47, at 310-329.

[47] 2 P. Areeda and D. Turner, Antitrust Law ¶ 409 (1980); 4 P. Areeda and D. Turner, supra n. 47, at 85-88; F.M. Scherer, Industrial Market Structure and Economic Performance 236, 252, 267-295 (2d Ed. 1980).

The third factor listed is the ability of smaller firms in the market to increase production in response to an attempt to exercise market power. This factor is discussed in the 1984 Merger Guidelines at § 3.43, and F.M. Scherer discusses this classic "response to a dominant firm" theory in his chapter on the dynamics of monopoly and oligopoly pricing.[48] Areeda and Turner have said that "[c]competing producers of products identical with that of a particular firm provide a complete check on that firm's market power only if they can readily expand production and sales at costs comparable to their present costs and to those of the firm in question."[49]

The fourth factor, the nature of the product and terms of sales, has likewise been considered critical by the vast majority of authors in antitrust and economics. F.M. Scherer states that when "no two orders are ever exactly alike or when there is leeway for deviations from the buyer's product specifications in hundreds of particulars, tacit coordination on joint profit maximizing strategies becomes virtually impossible to achieve."[50] Areeda and Turner note that "[a] given 'undue' level of concentration in a market of homogeneous goods would not have the same anticompetitive implications in a market of heterogeneous goods."[51] The Guidelines discuss Nature of the Product and Terms of Sale at some length in § 3.41.

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[48] F.M. Scherer, supra n. 49, at 232-252.

[49] 2 P. Areeda and D. Turner, supra n. 49, at 325.

[50] F.M. Scherer, Industrial Market Structure and Economic Performance 187 (1970). For a detailed discussion of product heterogeneity, see id. at 186-192.

The fifth factor, conduct of firms in the market, is also widely agreed to be important to the analysis of the effects of a proposed merger. Conduct of firms is discussed in the Guidelines at § 3.44, and by Areeda and Turner in their discussion on "Proving Market Power."[52] Judge Posner notes that "[i]n a market where collusion is attractive, there is likely to be a history of attempts at express collusion. . . Accordingly, a 'record' of price fixing or related antitrust violations is some evidence that the structure of the market is favorable to collusion."[53]

The last factor, efficiencies deriving from the acquisition, is perhaps the most widely embraced factor relevant to the effects of a proposed merger. Virtually all antitrust and economic authorities place extraordinary importance on the economies or efficiencies that a given merger may generate.[54]

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[51] P. Areeda and D. Turner, supra n. 47, at 91. See also R. Posner, supra n. 47, at 49-50.

[52] 2 P. Areeda and D. Turner, supra n. 49, at 344-5.

[53] R. Posner, supra n. 47, at 61.

[54] See F.M. Scherer, supra n. 49, at 81-118; R. Posner, supra n. 47, at 111-113; 4 P. Areeda and D. Turner, supra n. 47, at 146-199 ("the defense, where thought appropriate, should be deemed absolute" id. at 197); R. Bork, supra n. 47, at 204.

Thus, the Section of Antitrust Law believes that the great weight of authority corroborates the appropriateness of a codification of these consensus economic factors in the analysis of proposed mergers. Areeda and Turner, in discussing the limited role of non-economic values in merger analysis, note that "the Committee reports, traditionally the controlling source of legislative history, show clearly that no substantial incorporation of non-economic values into legal tests was contemplated...Imprecise as [the tests enunciated by the House report] may be, they seem clearly to ask for an assessment of competitive consequences in economic terms...."[55]

D. Conclusion

Enactment of the Merger Modernization Act would make needed changes in merger antitrust policy. With the change in the incipiency standard from "significant probability" to "reasonable probability," the bill would codify desirable trends in the recent case law and reflect the development of a responsible and respected body of economic analysis. For these reasons, the Section endorses, with the change in the incipiency standard, enactment of the Merger Modernization Act.

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[55] 4 P. Areeda and D. Turner, supra n. 47, at 11-12.

The CHAIRMAN. Thank you.

We now have questions. I have got to leave and go over to the Senate. I am going to ask the distinguished Senator from Ohio if he will preside until I get back.

Senator METZENBAUM. I will, Mr. Chairman.

The CHAIRMAN. I had to go to the dentist earlier today. I regret I was a little late, but I am glad you went ahead, Senator.

Senator METZENBAUM. Thank you. A little after 12, I am going to have to leave, and I know we have another panel coming up. I do not know how the chairman thinks we should proceed if he is not here and I am not here.

The CHAIRMAN. I will be back, I imagine, about 10 minutes after 12.

Senator METZENBAUM. OK, I will wait for you until then.

The CHAIRMAN. Thank you very much.

Senator METZENBAUM [presiding]. I just want to say to the panel this morning that each of you is particularly distinguished in your field—the head of a large corporation, counsel of the U.S. Chamber of Commerce, a distinguished law professor, and head of the antitrust division of the American Bar.

You all read your statements very well, but I do not think anybody up here on this side of the table had any idea what you were talking about. I just would say to you that I think it would be so much more effective—and who am I to tell you what to say, but really you were just reading words to us.

We are interested in the impact of this legislation, and I am frank to tell you that, Mr. Rill, you used some pejorative language that was found in some of the Court decisions.

What could be worse than consumer welfare? Who cares about consumers? Who cares about welfare? Some of us do, but I am afraid not too many. I just want to say that I am interested in how this is going to make a difference in the American economy. How is it going to help us as far as competitiveness is concerned?

I would ask you, Mr. Ong, can you give me some specific examples of mergers that have been stopped by the courts in the last 10 years because of the current standard, but that would have been allowed under the proposed new standard?

Mr. ONG. Yes. I think there have been a number, but I would also point out, Senator, that in addition to those which have been stopped by the courts, in your phrase, we have to consider those that have been stopped by the process and by the uncertainty that exists in the current statute and the case law that interprets it.

I referred in my brief statement to the, I think, excellent example cited by Secretary Baldrige dealing with an over-the-highway truck manufacturer. Here was a case where counsel, based upon the statute as written and the rather conflicting body of case law interpreting it, advised two clients in a row, major truck manufacturers, that they could not safely undertake a merger without being challenged.

In point of fact, each one of those American manufacturers was subsequently acquired by a foreign competitor which, in both cases, was substantially larger. If you assume that there was more possibility of an aggregation of market power, those two large foreign firms were much more likely to represent it than the merger of two domestic firms.

So just as in the enforcement statistics, the raw numbers do not really tell us a lot about the way the system operates, likewise in terms of things that are not done that could be done that would promote efficiency and benefit the consumer, we have got to look not only at what goes on in the courts, but what goes on behind the scenes.

I think an important aspect of S. 2160 would be the fact that it would give more certainty to the bar as they counsel business clients about what kinds of merger transactions are appropriate, would not have anticompetitive effects, and are not likely to be challenged by the enforcement agencies.

By the same token, these amendments in the statute would give more direction both to the enforcement agencies and to the courts, and would provide more consistency as they interpret the law.

Senator METZENBAUM. Let me ask you, when you say that they give more direction and the lawyers will be able to understand them better, how does a lawyer explain the language, "there is a significant probability that such acquisition will substantially increase the ability to exercise market power?"

Now, you have words that need definition—"significant probability," "substantially increase," and then "to exercise market power." Now, all of those are undefined terms, whereas with respect to the present language, we do know that literally hundreds of mergers have occurred and industry has been able to proceed forward.

Some of us think that they have been permitted to proceed forward too easily. I just do not follow why this language is preferable, except that its general thrust is to make possible more mergers than otherwise might occur.

I might say parenthetically, you mentioned the fact that foreign companies are now getting 25 percent of the American tire market. They previously were getting, I think you said, 6, if I remember correctly.

Mr. ONG. Less than 6, yes.

Senator METZENBAUM. Less than 6. I remember when Michelin was coming into this country and they had that new concept I forget. You would know it better than I. I think you have it now, also. What do you call that?

Mr. ONG. Radial tires.

Senator METZENBAUM. Radial tires. You make radial tires now, too.

Mr. ONG. We do, indeed.

Senator METZENBAUM. They were ahead of the field in that respect, were they not?

Mr. ONG. That is right.

Senator METZENBAUM. They did not get a share of the market because of competitiveness. I am not an authority on tires and I do not have any brief to hold for Michelin or anybody else. I would prefer that you make them rather than they make them, unless they are making them here in this country.

Yet, I think that that is the kind of competitiveness that we who sit in Congress are concerned that the American corporate world is losing sight of and rather is asking for protective legislation, not in this instance, but it does have a flavor of protectionism about it.

I wonder if you would care to respond to that.

Mr. ONG. Well, you have really asked me two questions.

Senator METZENBAUM. I did, indeed.

Mr. ONG. Let me respond by saying that far be it from me, sitting next to two distinguished antitrust practitioners like Mr. Rill and Mr Halverson, to answer the first question about what is the exact impact of the changed language in the bill.

I would say, however, that it does strike me that by specifically defining what market power is and by attaching, admittedly, somewhat broad but directive language about significant and substantial, that really does clarify the standard which an enforcer or a judge could apply. But I will leave it to my colleagues on the panel to speak with greater knowledge to that part of it.

Let me then turn to the broader policy issue which you are raising. The Michelin example is not included, incidentally, to any significant degree in the statistics I mentioned because Michelin did, in the early 1970's, enter this market and Canada. Michelin made a significant investment in U.S.-manufacturing facilities thus their domestically U.S.-manufactured products are not included in that 25 percent of the tire market that is currently served by imports. To that extent, they are considered an American manufacturer like any of the rest of us.

I think, though, that when we talk about——

Senator METZENBAUM. Where are most of the imports coming from?

Mr. ONG. The large importing countries—of course, Canada is a significant factor, and has been for a long time, which I think is natural. But if you look at the areas where there have been very dramatic increases in tire imports in recent years, the countries would be Japan, South Korea, Brazil, and to a lesser degree Taiwan. Those are the major ones.

We certainly, I think, in the Business Roundtable do not view this kind of legislation as protectionist in any sense. We feel, as I said in my prepared remarks, that the problem of competition, which is a real problem—some 70 percent of all the industry in this country now operates in a product market context which is global. The national borders of the United States are no longer the relevant factor in defining markets.

There is still 30 percent of the industrial economy where firms are able to compete pretty much on a national basis, but that percentage dwindles and, I would predict, would continue to dwindle with every passing year.

Our main response to that competitive challenge—I agree completely with your opening statement—is something for private firms and for the private sector to address, to address it technologically in terms of marketing techniques and the like.

We do, however, operate in this country in a regulatory environment which impinges upon and, to some extent, constrains our activities in the marketplace as businessmen. The antitrust laws and regulations are one aspect of that regulatory framework.

We simply feel that all of those regulations, including antitrust, need to be looked at by the Congress and, on the enforcement side, by the executive branch in the light of the realities of this global competition which affects so much of our industry today.

We feel that the thing we need in order to react effectively and quickly to these competitive challenges is certainty and clarity in what the law is and how it will be enforced.

We do not want to do anything that would impinge upon the rights and interests of consumers. Indeed, I think economic theory will bear out the fact that where efficiency is created in the firm, benefit to the consumer in the aggregate sense follows.

Senator METZENBAUM. Say that again. I am sorry.

Mr. ONG. I say where efficiency in firms occurs, then benefit flows to the consumers. Indeed, I would associate myself with the comment that the promotion of efficiency, and thus the enhancement of the consumer's interest, is the primary policy basis for the antitrust laws.

We think that by this legislation, its proponents are not seeking to narrow the test for anticompetitive activity. They are simply seeking to clarify for business planning purposes what is and is not anticompetitive.

In that sense, I think it is in no way protective and in every way helpful to business as it seeks to compete more effectively worldwide, and to the consumer.

Senator METZENBAUM. Thank you, Mr. Ong.

Mr. Rill, could you give me a specific example of a merger that would be barred if the companies attempted now, but would be allowed under the proposed standard?

Mr. RILL. I can answer that in a way that tags on to to your question to Mr. Ong. I was thinking of what mergers in the last 10 years—of course, your selection of time cuts off the mergers that were challenged in the 1960's—would be permitted under the proposed legislation that were barred in court decisions under existing law. I would say the Heilman/Pabst acquisition would be a good candidate for favorable treatment under the proposed legislation.

The Montfort challenge to Cargill's acquisition of another meatpacking firm, of course, is in the Supreme Court now, so we do not know how that is going to come out, or even if the substantive issues will be reached. But the 10th circuit decision certainly went off on a truncated market concentration structural analysis. The Warner/Polygram joint venture was barred in an FTC action in the ninth circuit. I am not sure that that would be barred under the proposed legislation.

Of course, what you are asking is my own personal view in crystal balling how the courts might come out under the proposal. I think that is a way of illuminating my views, but possibly not of so much value in predicting the actuality of the court decisions.

Let me give you an example of a case that went through the analysis that is suggested by the proposed legislation where the merger was blocked—a merger proceeding on the same track.

I do not say this with a great deal of enthusiasm, because I was counsel for one of the merging companies. That analysis took place in the carbon black merger litigation that came out of Cleveland where Judge——

Senator METZENBAUM. Which case?

Mr. Rill. One case was *Ashland/Bass Brothers* and the other was *Columbia/Conoco.* They were before Judge White in Cleveland, who went through a rather full-scale analysis not only of market share data, but of other factors, and preliminarily enjoined both acquisitions.

I suspect in those cases—whether we agree with the facts or not—at least the reasoning would be the same as would apply under current law.

Senator Metzenbaum. Would the change in the standard have an impact upon the RCA/GE matter that is presently pending?

Mr. Rill. I do not know all the facts of that matter, Senator. I think just from what I have read in the papers and what I know from public sources of the companies, the changed standard would not affect the outcome. I really am not the right person to ask that question because I am not that familiar with all the details of those two enterprises.

Senator Metzenbaum. Do you have an opinion as to the Eastern/Texas Air merger and the effect that the change might have?

Mr. Rill. Well, of course, that is currently pending. I would say again, without being involved in that matter, that the proposed standard probably would not have an impact. I know the Justice Department position in that matter tracks—rightly or wrongly on the facts—the analysis that the Justice Department is advocating in the proposed legislation, including particularly reliance on barriers to entry.

Of course, I think both FTC and Justice, and, for that matter, current economic thinking, view barriers to entry as the most important other factor that should be taken into account beyond pure market share or market concentration analysis.

Senator Metzenbaum. Professor Fox, do you believe the historical records show that trade deficits are related to antitrust enforcement?

Ms. Fox. There is a very indirect relationship between antitrust and the trade gap. The trade gap can best be closed by opening up markets, like opening up Japanese market.

Secretary Baldrige implies that big mergers will help close the trade gap. The claim assumes that big mergers are efficient. Second, it assumes that the merging companies would be export-oriented. Third, it assumes that the foreign markets are open. The assumptions are likely to be wrong.

I think the trade gap issue is a red herring.

Senator Metzenbaum. I thank the panel very much, and I think we will proceed forward with the other panel. I appreciate your cooperation.

Mr. Rill. Thank you, Senator.

Mr. Halverson. Thank you.

Senator Metzenbaum. The next panel is Lloyd Constantine, Assistant Attorney General for Antitrust, State of New York; John Satagaj, President of the Small Business Legislative Council; and Tom Wenning, of the National Grocers Association.

Mr. Constantine, I think each of you understands the rules that the Chairman has set up, and that is that no one will take longer than 5 minutes in his prepared statement.

Mr. Constantine, we are happy to have you with us.

STATEMENT OF A PANEL CONSISTING OF: LLOYD CONSTANTINE, ASSISTANT ATTORNEY GENERAL FOR ANTITRUST, STATE OF NEW YORK, ON BEHALF OF THE NATIONAL ASSOCIATION OF ATTORNEYS GENERAL: JOHN S. SATAGAJ, PRESIDENT, SMALL BUSINESS LEGISLATIVE COUNCIL, WASHINGTON, DC; AND TOM WENNING, EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL, NATIONAL GROCERS ASSOCIATION, ACCOMPANIED BY RONALD BLOCH, COUNSEL

Mr. CONSTANTINE. Thank you, Senator. My name is Lloyd Constantine. I am the assistant attorney general in charge of antitrust for the State of New York, in the office of Attorney General Robert Abrams, and I am also chairman of the Multi-State Antitrust Task Force of the National Association of Attorneys General.

But, today, I am at liberty to comment briefly on the position of Attorney General Abrams and to restate certain positions already taken by the national association.

Senator, I am going to take your invitation, having listened to the previous panel, and forget about what I was going to say and try to reduce this to the human dimension somewhat, if you will bear with me.

I will tell you what I think this is all about, and this will key into some of the things that previous panelists said. Let us just examine what would happen under the new law and what has happened under the old law.

Take, for example, the mergers now which are proposed in the soft drink industry, and I guess the question is whether they will go through under the current standard and whether they can go through under the proposed standard.

Well, the current and proposed standard are the same as far as enforcement goes, since the Justice Department is already enforcing the law in the manner in which they have proposed to change the law.

Look at those mergers, Senator. They will create two—that is, Coke and Dr. Pepper and Pepsi and Seven-Up—they will create two huge soft drinks companies that will control over 80 percent of the market.

I am sure you will recall that in 1980 Congress granted the soft drink industry the so-called soft drink interbrand competition reform, which was going to enable the soft drink manufacturers to vigorously compete against each other.

Having gotten that exemption from the antitrust laws, they now are not going to compete against each other, but acquire each other. My prediction is, at least from the Justice Department, these mergers will be allowed to go through, and it will eliminate some head-to-head competition.

For example, in the market relating to lemon-lime types of drinks—Seven-Up, Sprite, Slice—head-to-head, active, real competition will be eliminated, and I think that would be true under the proposed standard as well.

One of the most important aspects of the proposed law is the discussion of the importance of entry factors. The idea is that if your merger would elicit entry, then it is no particular problem.

I think it is important to say that the possibility, the hypothetical possibility of entry, is not a suitable surrogate for real competition. The fact that a year from now or 2 years from now or 5 years from now, somebody may come in and open a soft drink company or open a brewery, is not sufficient to meet the objection that right now head-to-head competition has been eliminated.

The Senator asked one of the previous witnesses about the Texas Air/Eastern merger. There, the position of the proponents of the merger is that even though the only two carriers that operate between LaGuardia Airport and National Airport and LaGuardia Airport and the Boston airport would be now merged into one entity, that is OK because somebody might enter the market down the line and they can buy some slots and they can come in, or you can get in your car and go out to McArthur Airport, 80 miles from New York, and get on a plane and go to Baltimore-Washington International Airport, or some such thing.

I think that is what this is all about, really, Senator. I think none of this really has any validity when held up to the light of actual fact.

We have heard a lot of talk about the new international realities, Senator, and that we are in a world market now. Students of antitrust history recall that during the post-World War I period when United States Steel was being contested by the Government at the time, the proponents of the United States Steel Co., which had 50 percent of the market, said that it was necessary to have a company of that size to compete in all the markets of the world.

There is nothing particularly new about these arguments, Senator. They are the same arguments that have been made for six decades now.

United States Steel was allowed to maintain its size of 50 percent of the market. It is still the biggest steel producer in the world, highly inefficient. It is getting killed in world markets, and it is getting killed by companies that are a lot smaller.

I do not need to tell you about what happened with LTV and Republic Steel; you know all about that already, and a lot of other mergers like that.

The attitude which is embodied in the proposed legislation and which is embodied in the enforcement policy of the Justice Department has already elicited a certain response from the business community.

I read a couple of weeks ago that—well, I would just like to tell you about the ad agency mergers, Senator. Three of the world's 20 largest ad agencies are going to merge into the world's largest ad agency. The reason that they say they want to do that is so they will not have pressure from their stockholders to go out and get every piece of business.

That is a naked anticompetitive purpose, and that is the response which the business community has made to these proposals and the enforcement policy of this administration.

My time is up, but I will be glad to amplify on some of these things and answer your questions later on. Thank you, Senator.

[The prepared statement follows:]

STATEMENT OF

LLOYD CONSTANTINE
ASSISTANT ATTORNEY GENERAL
IN CHARGE
ANTITRUST BUREAU
OFFICE OF THE ATTORNEY GENERAL NEW YORK STATE

CHAIRMAN MULTI-STATE ANTITRUST TASK FORCE

NATIONAL ASSOCIATION OF ATTORNEYS GENERAL

Mr. Chairman and members of the Committee. Thank you for this opportunity to briefly address you today and to answer any questions you might have. My name is Lloyd Constantine. I am the Assistant Attorney General in Charge of Antitrust for the State of New York in the Office of New York Attorney General Robert Abrams. I am also Chairman of the Multi-State Antitrust Task Force of the National Association of Attorneys General, a group comprised of the Antitrust Chiefs of 9 states, which reports to the 50 State Attorneys General and their antitrust Chairman, Bob Abrams.

NAAG is currently formulating a comprehensive analysis of the Administration's Antitrust proposals which will be transmitted to this Committee. Today I am at liberty to comment briefly on the position of Attorney General Abrams and to restate certain positions already taken by NAAG which are germane to certain elements of the Administration's merger proposals.

The Merger Modernization Act is a codification of the Justice Department's Merger Guidelines last revised in 1984, which in turn is the Departments interpretation of the current standards of Clayton Act Section 7. This either shows that the current Section 7 standard is sufficiently flexible to accomodate the Administration's notions about competition or that the Division is currently enforcing Section 7 in a manner inconsistent with the purpose of that law. The latter is obviously true and has been amply demonstrated in public statements emanating from the Division. For example, when Paul McGrath initially sought to block the 1984 merger of LTV and Republic Steel, Commerce Secretary Baldridge called for the total repeal of Section 7. McGrath responded that since the Division interpreted Section 7 as adding nothing to Sherman Act Section 1, that repealing Section 7 would be a meaningless gesture. Although the extensive legislative history of the 1950 Celler-Kefauver amendments and the Supreme Court's subsequent unequivocal interpretation of the Section 7 standard demonstrate what nonsense this is - it remains an unfortunate reality that the Administration has been able for the past five years to treat Section 7 as a nullity. Furthermore, this Committee has already heard from numerous eminent witnesses that current Section 7 is broad and flexible enough to require that effective foreign competition, entry conditions and all other economic and market factors be assessed in determining whether there is a "reasonable probability" that a merger may substantially lessen competition or tend to create a monopoly. The Courts' are already interpreting Section 7 in this manner and the Administration has candidly asserted that the merger modification Act is designed to prevent future Administrations from enforcing Section 7 in a more expansive manner. More expansively say than taking token action on 5 out of 1604 mergers, which is the Department's record for 1985.

Although the proposed legislation is not necessary to permit foreign competition, entry conditions, market power and other economic factors to be weighed in a Section 7 case, as they currently are, the Merger Modernization Act would make it functionally, if not theoretically, impossible to halt any merger before significant damage had already been done and it would reduce the broad concept of competition embodied in Section 7 and other federal antitrust statutes, to a single preoccupation with the exercise of "market power". Let me outline how the Merger Modernization Act would produce this result.

First, under the proposed standard there must be a "significant probability that the merger "will" create an entity with "market power" and that the entity will have the opportunity to abuse that market power. Such certain proof of future economic conditions will be nearly impossible to produce and contrasts with the already rigorous existing standard requiring proof that the effect of the merger "may be" substantially to lessen competition. Case law under this standard requires a "reasonable probability" of antitcompetitive effect and the Supreme Court has observed that Section 7 was enacted to deal with "probabilities not certainties" since "statutes existed for dealing with clear-cut menaces to competition ..."*. The proposed act would repeal the "incipiency" standard which was a major concern of Congress in enacting the 1950 amendments. By abolishing the incipiency standard, Section 7 will not merely become redundant with Sections 1 and 2 of the Sherman Act (which are a sufficient remedy for mergers whose anticompetitive effects are certain and demonstrable) but it would actually produce a Section 7 remedy less effective than these Sherman Act provisions. This would occur because the second major substantive change under the proposed Act would contract the definition of anticompetitive effects to the single concept of abusive exercise of market power. Market power is defined in the Act as "the ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time." Under this definition, market power is virtually synonymous with "monopoly power" and Section 7 of the Clayton Act becomes a mere adjunct of Section 2 of the Sherman Act, which outlaws monopolies. Mergers which result in anticompetitive effects other than the exercise of market or monopoly power, such as reciprocal dealing, cross-subsidization and cornering of supply markets, currently reachable under Section 7, would now be beyond the scope of the statute. As I have observed, the Division currently treats the Section 1 and Section 7 standards as equivalent, rendering Section 7 a nullity. Enactment of the Merger Modernization Act would go beyond this and inevitably elicit defendant's claims that the new Section 7 standard, then narrower than Section 1, was the exclusive remedy for attacking an anticompetitive merger.

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* Brown Shoe Co. v. United States, 370 U.S. 294, 323-4 (1962).

If this is the moment in our history when the Congress acquiesces in the Administrations's request that we abandon the broad concept of competition which the Congress codified in the Clayton Act, then we should pause briefly to review what is being discarded.

In addition to the distributive goal of preventing unfair acquisition of consumer wealth by firms with market power, the Congress understood competition to embrace, and the antitrust laws to protect, the goals of productive efficiency, product and organizational diversity, local control of business, the opportunity for small businesses to thrive, and most important, the prevention of dangerous levels of economic concentration to curb not only the misuse of economic power but to check the social and political power of large businesses. [I recently had a sobering experience at Walt Disney's Epcot Center. As I rode around on the various impressive roller coasters constructed by multinational industrial giants - I heard a consistent message that my future and the future of my children was in the good hands of these corporations - I was not comforted then, but I am truly distressed now to find the Administration conveying the same message by seeking abolition of the broad antitrust vision of Clayton Section 7].

One clear effect of the Merger Modernization Act would be to prevent any challenge of vertical or conglomerate mergers which could harm competition as currently defined, but could not be demonstrated to produce a certain abuse of "market power". By doing so, we would abandon the Celler-Kefauver reforms of 1950, which Secretary Baldridge assures us are obsolete, because of the new international market. [Parenthetically, students of antitrust history know that during the post World War I period, apologists for U.S. Steel, then under an unsuccessful government attack, argued that a firm controlling fifty per cent of the market would be able to "successfully compete in all the markets of the world."] We would also ignore Congressional studies of this decade which detail the harm done by conglomerate mergers. These include:

1) The destruction of local and independent businesses which tend to be the most productive, innovative, and the most prolific job generating sector of the economy.

2) The increase in the level of economic concentration.

3) The fact that conglomerate mergers rarely produce new productive resources or develop new markets.

4) A conglomerate's tendency to stress short-term profit maximization.

5) The perversion of local political processes by the necessity to court favor with distant corporate interests and

6) The distortion of cash flow and capital flow patterns which result from acquired companies acting as banking institutions for the parent company.

Based upon these and other findings of the Committee on Small Business of the House of Representatives, federal antitrust officials recommended that Clayton Section 7 was inadequate to deal with the wave of conglomerate mergers and ought to be strengthened.*

The third major change proposed by the Administration sets out six specific factors plus a seventh catch-all factor to be considered in determining whether the merged entity will be able to exert market power. I see no problem in considering efficiency as one important factor in the analysis but several words of caution about efficiency justifications for both business and consumers. Large but weak corporations like LTV and Republic Steel or Pan Am and National Airlines often view merging as a solution to their respective inefficiencies. A combination of financially weak, technologically backward, or otherwise troubled firms usually amounts to nothing more than bloated inefficiency, plant closings and reduced consumer choice. Recent studies by Frederic Scherer, David Ravenscraft, Dennis Mueller, Edwdard Herman, Louis Lowenstein and the Federal Trade Commission Staff all cast serious doubt on the notion that mergers and takeovers typically produce substantial efficiency benefits.

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* "Conglomerate Mergers - Their Effects On Small Business And Local Communities", Report of the Committee on Small Business, House of Representatives, Ninety-Sixth Congress, Document No. 96-393, pp. 47-9 (1980).

Furthermore efficiency justifications should not cleanse an otherwise illegal merger. This should be made specific in any bill. If a merger takes place in an industry where entry barriers are high but the merger would create an efficient entity, there is no reason to believe that the merged entity would pass along its savings to the consumer.

A final point about the seven factors incorporated into the proposed Act are their vagueness and the absence of any direction as to their relative weight. I am sure they will be good for two industries. The uncertainty created by the proposed formulation will employ many laywers and economists for many years in endless argument.

Since the Administration intends to codify its current merger policy in the proposed Act, I will conclude my comments by making some brief observations about the effect that this policy has already had on the business community. I need not recount the number of recent mega-mergers, their escalating size and the sorry results that many of these mergers have already produced. Each day we awake to find a bigger deal, such as the proposed G.E. - R.C.A. combine or one which would produce a grotesquely concentrated industry, such as the proposed soft-drink mergers. The merger activity of the 1970's which was predominantly vertical and conglomerate has shifted to horizontal mergers which produce effects similar to, but more permanent than, horizontal price-fixing and market allocation schemes but are subject to the rule of reason because of the possibility of efficiencies.

Business has clearly seen the window of opportunity created by a policy of no enforcement, but even I am amazed at how candid and brazen the proponents of these mergers have become. Two weeks ago, three of the worlds top twenty advertising agency groups agreed to merge into an entity which would be the world's largest, and which they characterized as "advertising's global creative superpower." One of the reasons for merging stated by Allen G. Rosenshine Chairman of BBDO was that it would remove some of the pressure from the individual agencies to pursue "every piece of new business to keep the stockholders happy." "3-Way Merger to Create Largest Ad Agency", New York Times, April 28, 1986, p. 1, rol. 3.

Business has clearly gotten the Administration's message. Incantations about inefficiency are no longer necessary. An open anticompetitive intention will suffice. I will be pleased to try to answer any questions you might have.

Senator **Metzenbaum**. Thank you very much, Mr. Constantine. John Satagaj, president of the Small Business Legislative Council.

STATEMENT OF JOHN S. SATAGAJ

Mr. **Satagaj**. Thank you, Mr. Chairman. My name is John Satagaj and I am president of the Small Business Legislative Council. On behalf of our organization, I would like to register our opposition to S. 2160.

SBLC is a permanent coalition of 88 trade associations, representing over 4 million small businesses. I believe it is safe to say that SBLC and the Department of Justice have fundamentally different opinions about the purpose and goals of antitrust policy, and I am here for perhaps one reason, to bring a message to this committee that those values which are so easily dismissed in this process are important values in antitrust policy.

Senator **Metzenbaum**. Mr. Satagaj, how do you pronounce your name?

Mr. **Satagaj**. Satagaj.

Senator **Metzenbaum**. Satagaj?

Mr. **Satagaj**. Yes.

Senator **Metzenbaum**. You should hear what they do with Metzenbaum.

But I wanted to ask you, what is the difference between the Small Business Legislative Council and some small business group that is an arm of the U.S. Chamber of Commerce?

Mr. **Satagaj**. This is a totally independent organization. The chamber has a Council of Small Business, which they operate, of their members. SBLC is a wholly independent group of the 88 trade associations. It is fully funded by those trade associations.

I serve as the staff of that organization. There is no connection whatsoever with the chamber of commerce.

Senator **Metzenbaum**. You speak for a much larger group in the small business community than do they?

Mr. **Satagaj**. Well, that is always the subject of debate as to how many members are in one organization or another. Through our member organizations, there are 4 million small businesses represented by our coalition.

Obviously, there is a great deal of overlap with a group such as the chamber of commerce, for example, or other small business groups like the National Federation of Independent Business. There is overlap between the groups in terms of their baseline membership, but we are an independent organization.

Senator **Metzenbaum**. Thank you.

Mr. **Satagaj**. The subject I am here to talk about is that if SBLC has a preference, let it be said we prefer the Jeffersonian ideal of decentralized and deconcentrated economic and politic power, and we make no apology for it.

A diversified economy dominated by an abundance of small businesses producing jobs, innovation, and economic freedom are the cornerstones of the American enterprise system. Some may consider this mere rhetoric and characterize it as nostalgic, but I believe the facts demonstrate the continuing validity of Jefferson's economic thesis.

I would ask those who would consider such values as outmoded whether they believe that small business is a vital sector of our economy. We would say it is. Small business continues to create the bulk of new jobs in our economy. It is an innovator, and it is an active diversifier of our economy.

Dun and Bradstreet recently reported that small firms will produce two-thirds of the new jobs in 1986. In 1985, the chief counsel for advocacy for small business, in the President's report on small business, reported that small businesses did create, between 1982 and 1984, jobs at an astounding rate, while large firms actually had a net loss.

The Department of Justice would have us believe that mergers would do us no harm. We are not here to debate the concepts of market share or market power. Rather, we believe this proposal brings into focus the question of the fundamental purpose of our antitrust laws.

It is our belief that the concentration of economic power transcends some narrow definition of competition based on market shares. Freedom of economic opportunity, the right to own, manage and control one's business, and to gain economic freedom to participate in the community are essential goals. We believe merger activity should be put to these tests.

What good is achieved by mergers? The proponents argue for economic efficiency, to weed out management inefficiency, and to use mergers as an effective redeployment of capital. I would say that studies conducted in these areas demonstrate that these are not, in fact, valid concerns.

Further, proponents would argue that mergers somehow foster innovation. Studies have repeatedly shown small business to be innovative-oriented. The 1985 State of Small Business Report prepared by the Office of Advocacy cited recent studies demonstrating the correlation between business size and innovation.

It states,

> A primary finding of this study is that the innovation rate, or the number of innovations per million employees, for small firms substantially exceeds the innovation rate for large firms.

The Congress itself has recognized the role of small business in innovation and passed the Small Business Innovation Development Act in 1982

Ironically, one of the true economies of scale that mergers actually achieve is the ability to lobby. Consolidation of political strength is one of the unfortunate byproducts of any merger activity.

One of the greatest dangers of Government-sized business, with all its trappings, is the ability of such businesses to wield political and economic clout in a community.

I might add parenthetically that Government-size entities usually have bureaucracies to go with them.

In conclusion, we urge this committee to look carefully at the full value of antitrust laws to our society and economy. We do not believe the values under which previous mergers were measured are, in fact, outmoded and antiquated.

To the extent that we can achieve a diversified economy, bringing forth jobs and innovation, we will be fulfilling the model for America.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF

John S. Satagaj
Before the
Committee on the Judiciary
U.S. Senate
May 12, 1986

My name is John S. Satagaj, President of the Small Business Legislative Council (SBLC). On behalf of our organization, I would like to register our opposition to S. 2160.

The Small Business Legislative Council (SBLC) is a permanent coalition of eighty-eight trade associations representing over four million small businesses. Our sole mission is to represent the interests of small business in national policy matters.

I believe it is safe to say, SBLC and the Department of Justice have fundamentally different opinions as to the purpose and goals of antitrust policy. It may be an unfair oversimplification to suggest that the Department believes economic efficiency, absent the showing of a dramatic, negative impact on competition in the narrowest sense, is a worthwhile objective, while SBLC believes economic decentralization, absent the showing of a compelling need for concentration, is a principal philosophy of our society, nevertheless I am compelled to suggest such is the case.

The Department's proposal will render the Clayton Act meaningless. It will require the demonstration that there is a significant probability that a merger will increase the ability to exercise market power. The ability to exercise market power is defined as the ability of one or more firms profitably to maintain prices above competitive levels for a significant period. These changes are cloaked in a mantle of modern merger analysis, in the interests of economic efficiency, innovation and the consumer welfare. To SBLC it is nothing more than a disguised attempt to rework the entire premise upon which our economy is based. Tagging a concept as "modern" does not make it better.

In 1979, the Senate Committee on Judiciary held hearings on proposed legislation to put an additional cap on conglomerate mergers and the small business community supported that legislation. While we recognize this current legislation addresses only vertical and horizontal mergers, the hearing record of those proceedings is a marvelous resource for the debate before us today as the basic issues remain the same. Much of what I say today is a reendorsement of small business' position at that time.

If SBLC has a preference, let it be said we prefer the Jeffersonian ideal of decentralized and deconcentrated economic and political power. Justice Brandeis is noted for articulating some of Jefferson's assumptions within the context of antitrust law upon which we believe our society and economy is built, and upon which it flourishes. A diversified economy dominated by an abundance of small businesses, producing jobs, innovation and economic freedom are the cornerstones of the American enterprise system. Some may consider this mere rhetoric, but I believe the facts demonstrate the continuing validity of Jefferson's thesis.

Small business continues to create the bulk of new jobs in our economy. Dun & Bradstreet recently reported small firms will produce two-thirds of the new jobs in 1986. In 1985, the Chief Counsel for Advocacy for Small Business in the President's Report on Small Business reported that small businesses between 1982-84 created new jobs at an astounding rate while large firms actually had a net loss.

The Department would have us believe that mergers would do us no harm. Harm, as they would have it, would be measured only by an increase in price to the consumers over a significant period of time. It is not our intention to debate the relative merits of how one measures the scope of competition and marketshare. Rather, we believe this proposal brings into focus the question of the fundamental purpose of our antitrust laws. It is our belief, that the concentration of economic power transcends some narrow definition of competition based on marketshares. Albeit, the concentration of marketshares and the exercise of market power are important considerations, but we would not limit our examination simply to that concern. Freedom of economic opportunity, the right to own, manage, and control one's business and to gain the economic freedom to participate in the community are essential goals. We believe merger activity should be put to these tests.

In 1979 this Committee received testimony concerning a case study of the impact of the acquisition of Carrier Corp of Syracuse, New York by United Technologies. Central to the case study, and borne out by testimony of local business owners was the impact of such mergers not only in the loss of direct jobs but the residual effect on local suppliers, contractors, support services and ultimately the community. Diversification of a local economy is a high priority for local leaders.

What good is achieved by mergers? Economy efficiency is frequently cited as the number one benefit. The myth of economies of scale are just that, myths. Michael Scherer of the Brooking Institution has done a study of the economic efficiency of mergers. The results seem to indicate little if any economic efficiency is achieved by such activity. Further, after a certain point the economies of scale yield no additional benefits in capital markets.

Second, it is suggested mergers weed out management inefficiency. I would be surprised to hear if any firm would acquire another company unless it was an attractive candidate with sound management and Mr. Scherer reports that contrary to popular belief, most acquired firms were quite profitable prior to acquisition.

Third, it is suggested mergers achieve effective redeployment of capital. Given the creative use of leverage buy-outs, it is difficult to see how this can be accomplished. Burdened with debt, it would seem the new firm's options would be restricted.

It has also been suggested that permitting mergers will somehow foster innovation. Studies have repeatedly shown small businesses to be innovation oriented. The 1985 State of Small Business prepared by the Office of Advocacy cited recent work demonstrating the correlation between business size and innovation. It states: "A primary finding of this study is that the innovation rate, or the number of innovations per million employees, for small firms substantially exceeds the innovation rate for large firms." The Congress itself, has recognized the role of small business in the innovation process. In 1982 Congress passed the Small Business Innovation Development Act to encourage government recognition of small business contributions to innovation.

I can not recall who said it at the 1979 hearings, but one of the true economics of scale that mergers actually achieve is in the ability to lobby. Consolidation of political strength is one of the unfortunate by-products of any merger activity. One of the greatest dangers of Government-sized business, with all its attendant trappings, is the ability of such a businesses to wield political and economic clout in the community. I might add parenthetically, government-sized entities usually have bureaucracies to go with them. The larger the organization the more likely the tendency to create additional layers of bureaucracy. I would be interested in hearing from the industrial organizational specialists as to whether mergers result in bureaucratic consolidations or expansions in the long run. Further, bureaucracies and innovation seldom mix.

It seems to us if there is one advantage to recent mergers, it has been the sale of "unwanted assets". While we have not seen any empirical data, it is our guess many of these so-called unwanted assets were once productive assets, unwisely acquired. Spun-off to begin life anew as an independent entity, we feel these "unwanted assets" will once again become productive.

Assuming for a moment, that antitrust law should be confined to a much narrower concept of competition, the Department has not demonstrated any need to change the law. The courts and the Department's own guidelines have brought some order to the process. Frankly we believe current law should be vigorously enforced. Courts have considered competition not only in the context of affirmative exercise of market power but also the impact on potential competition and the impact of reciprocity against suppliers among others. The consumer suffers not only as a result of the direct increase in price but through the change in our overall economic base. The legislation would overrule the validity of such argument. The standard which the Department has proposed is a standard which can not be met, and it is tantamount to providing free reign to merger minded executives.

In conclusion, we urge this Committee to look carefully at the full value of antitrust laws to our society and economy. To the extent we can achieve a diversified economy, bringing forth jobs and innovation, we will be fulfilling the Jeffersonian model for America.

The CHAIRMAN [presiding]. Thank you.

Mr. Wenning.

STATEMENT OF TOM WENNING

Mr. WENNING. Thank you, Mr. Chairman. I am Tom Wenning, executive vice president and general counsel for the National Grocers Association. Mr. Baska sends his regrets that he is unable to be here today. He had an emergency at his warehouse.

NGA represents over 2,000 retailers and 60 wholesalers who serve them. NGA speaks today on behalf of those retailers and wholesalers in the independent sector of the food distribution industry.

I am going to ask, with your permission, that Ron Bloch summarize the NGA statement and give our reasons for opposition to S. 2160.

The CHAIRMAN. Mr. Bloch, did you have anything to say?

STATEMENT OF RONALD BLOCH

Mr. BLOCH. Yes. Thank you, Mr. Chairman. I am Ronald Bloch, with the law firm of McDermott, Will & Emery here in Washington.

Mr. Chairman, the Nation's antitrust statutes have not been subject to fundamental alteration for many decades. During that time, our economy has prospered, American business has flourished, and the American consumer has been well served.

With such a record of success, we strongly believe that any statutory amendment or addition should be approached with the utmost caution. The potential risk involved in abandoning an efficiently functioning legal system mandates that the most careful study and examination be given.

More important, Congress should demand clear and compelling evidence that there are substantial economic disruptions or inequalities in order to justify alterations of our basis approach to mergers

My first point, Mr. Chairman, is that no such evidence now exists. Indeed, the facts are that we are currently engaged in the largest and most sustained merger wave in American history.

In 1985 alone, it is estimated that more than 3,000 mergers and acquisitions took place, totaling more than $2 billion in value. Within such a climate, surely it is the burden of the proponents of these legal changes to offer significant examples of more than one or two mergers which have failed to pass muster under existing legal interpretations.

Is it not totally reasonable to request a list of proposed mergers that are now illegal that would pass muster under S. 2160, and to demand proof of their real benefit to the economy of this country?

Second, NGA would strongly endorse the proposition that the Nation's courts and its antitrust enforcement agencies require flexibility in their interpretation of the antitrust statutes.

Section 7 of the Clayton Act has historically provided just that flexibility. S. 2160 would not. Indeed, in arguing that this bill would codify existing interpretations and analytical standards, its supporters have actually introduced a potent argument against its adoption.

The fact is that the basic law of economic life is change. Certainly, merger analysis and economic learning have become far more sophisticated in recent years. Similarly, economic conditions and marketing concepts, both domestic and international, have become far more complex.

Only a dynamic, flexible, evolving statute, not a rigidly static one, can effectively deal with these changing conditions.

Indeed, Mr. Chairman, had Congress codified the economic theories of the 1940's and the 1950's into the Celler-Kefauver amendment to section 7, it would have been impossible to have produced the very statutory interpretations that the present bill would codify.

Our final point, Mr. Chairman, is that the bill's emphasis upon economic efficiency is most unwise and undesirable. Certainly, there is virtually no empirical evidence to support the premise that most mergers are efficient.

Indeed, recent studies by a number of leading economists, as well as by the Federal Trade Commission staff, all call such a proposition into serious question. In fact, most real-world examples would suggest that an increasingly large number of megamergers are actually turning sour.

Quite often, the factors inherently involved, such as more complex management tasks, significant new debt, and combined operating difficulties, produce more inefficiency, not less.

As Federal Reserve economist Stephen Rhodes graphically put it recently, you do not put two turkeys together and make an eagle.

This bill would place undue emphasis upon economic efficiency in section 7 proceedings by allowing efficiency as a defense. Other relevant concerns would be neglected. Presently, section 7 offers a social and political judgment that more competitors are better than fewer.

The law seeks to promote growth through healthy competition rather than by acquisition. A truly competitive marketplace, one in which new firms may enter freely and in which small, efficient firms may profitably expand, can only be preserved through intelligent limitations upon acquisitions and mergers.

S. 2160 would change those limitations and encourage more mergers and acquisitions. Small business, in general, and the National Grocers Association, in particular, believes that the values to American consumers offered by preserving the maximum number of efficient competitors in terms of service, convenience, diversity and economic well-being should not be replaced by the cold, impersonal criterion of economic efficiency.

I see that my time is up, Mr. Chairman, and I thank you for your time.

[The prepared statement follows:]

STATEMENT

OF

JAMES BASKA

Vice Chairman, National Grocers Association

Good morning Mr. Chairman and members of the Committee. My name is James Baska. I am President of Associated Wholesale Grocers, Inc., in Kansas City, Kansas. My firm serves over 700 retail food stores in Kansas, Missouri, Oklahoma and Nebraska. I am also Vice-Chairman of the National Grocers Association ("N.G.A."), a non-profit trade association of 2,000 retail grocery firms and over sixty regional wholesale grocery distributors serving over 28,000 food stores in the United States. These retailers, and the wholesalers who serve them, are commonly referred to as the independent sector of the food distribution industry. Our competition comes mainly from the larger integrated national food retailers. So that there is no mistake, Mr. Chairman, it is the viewpoint of the independent sector that N.G.A. represents and that I will set forth today. N.G.A. also has been recognized as the voice of small business in the food distribution industry. We have always favored strong enforcement of the antitrust laws and have stated this position publicly on numerous occasions.

Presently pending before the Senate are antitrust proposals that affect the vital interests of the members of N.G.A. and others in the small business community. We believe that the bills that would amend Section 7 of the Clayton Act and that would eliminate most treble damage recoveries would dramatically weaken our antitrust statutes. N.G.A., by a resolution of its Board of Directors, unequivocally and vigorously opposes both of those changes.

I am grateful for this opportunity to express N.G.A.'s views on S.2160, the Merger Modernization Act of 1986, and on that portion of S.2022, the Antitrust Improvement Act of 1986, that deals with substantive merger analysis.

Let me first address S.2160. That bill would make dramatic changes in the language of Section 7 of the Clayton Act and would appear to change the congressional purpose that underlies Section 7 in its present form. Under the proposed amendment, firms apparently would be permitted to grow by acquisition up to a point just short of having monopoly power. Experience has shown that by then it is often too late to reestablish a competitive marketplace using divestiture as the primary remedy. The philosophy underlying Section 7 is to prevent the accumulation of monopoly power in its incipiency. That philosophy was recently reinforced by enactment of the premerger reporting requirements of the Hart-Scott-Rodino Antitrust Improvements Act. N.G.A. opposes this attempt to change our basic merger policy from one of prevention to one of cure.

Let us look more specifically at the language of the bill. Instead of interdicting mergers and acquisitions whose "effect. . . may be substantially to lessen competition or create a monopoly," the bill would make Section 7 apply only when "there is a significant probability that such acquisition will substantially increase the ability to exercise market power." The bill would narrow the focus of Section 7 from the broader inquiry into all possible anticompetitive effects, to the sole question of whether the merged firm could exercise market power. The bill then defines market power as the ability to profitably maintain prices above competitive levels for a significant length of time. Thus, in determining the legality of a merger, the courts would be barred from any consideration of the anticompetitive effects of reductions--even the elimination--of all forms of non-price competition. We believe that this drastic change is unwise.

Next, the bill provides a checklist of factors that must be considered by the courts when attempting to determine whether the ability to exercise market power will be substantially increased. In addition, the list seems to recognize efficiency for the first time as a Section 7 defense. That checklist greatly reduces the interpretational flexibility afforded by the present language of Section 7. And having given the courts a list of mandatory factors to consider, the bill gives no guidance in how to weigh the factors on the list; it mandates only that all of the listed economic factors be "duly" considered. N.G.A. believes that these changes will make the law less, rather than more, effective.

The National Grocers Association on numerous occasions has publicly stated its position in favor of vigorous, even-handed enforcement of the antitrust laws. Yet we have noted a dramatic decline in government enforcement activity in the last few years, especially merger enforcement under Section 7. Nevertheless, proponents of S.2160 argue that the present merger law is too restrictive and that it prevents pro-competitive mergers. And an argument is all they offer. They have yet to identify a single merger that Section 7 is now preventing. There is a heavy burden on those who seek this amendment, for they would radically revise a statute that has been one of our fundamental business guideposts for over seventy years. Their burden is to prove that there is a problem with the law as it now stands and that there is a need for a change; they must identify the beneficial mergers that cannot take place under existing law. Until there is a clear and convincing factual record showing that Section 7 is presently having a net detrimental effect, this amendment cannot be justified. N.G.A. challenges the supporters of S.2160 to make their factual record.

A recent article in Newsweek estimated that in 1985 there were over 3,000 acquisitions worth roughly $200 billion. One organization, which keeps track of food industry statistics, counted over 500 mergers and acquisitions during 1985 in food and food-related industries alone, none of which was challenged. My point is not to suggest that any of those mergers should have been challenged. I point to these figures only to show that on such a record, one can hardly argue that present law is somehow preventing pro-competitive mergers.

Until the supporters of S.2160 prove their case, Section 7 should not be amended.

One of the great advantages of Section 7 is the flexibility that its language gives the courts and the enforcement agencies. Many supporters of S.2160 have stated that the bill merely codifies existing interpretations and analytical standards. If this is true, then it is an effective argument against amending the statute. Certainly, no one can argue that merger analysis has not become more sophisticated over the last two decades. As our econimic learning has increased and that learning has supplied us with new analytical tools, so has our approach to merger analysis advanced. Those changes--in the way we define geographic and product markets and measure the likelihood of anticompetitive effects--have occurred under a statute which has not been amended in over thirty-five years. Had Congress codified the economic theories of the 1940's and 1950's into the Cellar-Kefauver Amendment to Section 7, it would have been impossible to have produced the very interpretations that the present bill would codify.

And what will happen tomorrow? As our knowledge and understanding of markets continues to grow, we may find that some of the factors that the bill would compel us to consider are better replaced by new analytical devices. And I predict that one day we will find that the ability to exercise market power has not been the sole vice of mergers and acquisitions. We should not need an Act of Congress to make it possible to incorporate that new wisdom into the decisional process. N.G.A. believes that the supporters of S.2160 have failed to show that the language of Section 7 needs to be changed. In fact, the very changes that they support have come about under the law's existing language. Section 7 should remain undisturbed, giving future courts, enforcement agencies and private parties the ability to adapt the language and application of the law to evolving theories and the changing needs of the times.

N.G.A. also objects to this bill because of its apparent assumption that nearly all mergers are efficient and hence beneficial. Building upon that theory, the bill would make the law less restrictive than it is today--a frightening prospect to the medium and small businesses that face ever-increasing difficulties competing with the larger entities that have been created recently through mergers.

I know of no empirical evidence to support the notion that most mergers are efficient. While some economic theorists may honestly believe that, the facts that are beginning to surface suggest otherwise. Significant numbers of recent mega-mergers are turning sour because of the inability of management to properly oversee their new enterprises, because the debt incurred in making these acquisitions is too high, or because the combined operations have created inefficiencies that were not perceived at the outset. Numerous other reasons have been reported. Although these factors may not all be appropriate in an antitrust analysis, they do raise fundamental questions about a critical assumption upon which S.2160 seems to be based.

Let us look at what we do know about mergers--especially in the grocery industry. Some background information on recent trends might be helpful. Ten years ago there were roughly 1,000 wholesale grocery companies serving the independent grocery retailers. In the intervening decade that number has dropped to about 400. One knowledgeable and respected wholesaler recently predicted that by 1990 the number will be down to 100. And no one in the industry is seriously questioning that prediction.

At the same time, grocery retailing has undergone significant changes. The market share of the chain stores has grown while the independent retailers' share has declined from forty-nine to forty-four percent. That equals a dollar sales loss of over fourteen billion dollars in 1985 alone.

I am not suggesting that all of this activity at both the wholesale and retail levels has been the result of mergers. I offer these facts in order to give the Committee an impression of the business background against which N.G.A. views the proposed amendment to Section 7.

Mergers often eliminate buyers' choices. And it is the very existence of those buying options that creates competitive markets. While economists may disagree on the number of competitors that is needed to create a competitive market, everyone seems to agree, generally, that as the number of competitors decreases, so does the vigor of competition. Even though a merged firm may not be able to exercise market power as defined by the bill, there is a reduction in the number of separate entities making day-to-day competitive decisions, researching and deciding which products will be sold, deciding which geographic areas will be opened to new competition, developing strategies to increase business by giving the consumer a different price-product-service mix, making judgments that, together with those of its competitors, create the environment in which consumers get the highest quality at the lowest price. Yet, under S.2160 none of these anticompetitive results could provide the basis for finding a merger unlawful under Section 7.

That model of a competitive market cannot exist when there are but a few large competitors who do not feel the force exerted by smaller firms. For it is those smaller entrepreneurs who are responsible for most of the innovation that is found in the marketplace. This bill, by relaxing merger standards and imposing a more difficult burden of proof, is more likely to encourage merger activity beyond today's record levels, adding to the problems faced by smaller businesses and make it more difficult for them to survive. N.G.A. believes that this bill is based upon flawed economic theories. Any statutory change should be designed to perserve the maximum number of efficient competitors, regardless of any inability of the incumbents to raise prices above competitive levels.

That brings me, Mr. Chairman, to my final point on S.2160. This bill would go far toward making economic efficiency the sole focus of merger policy. This result is clear from the use of a narrowly defined market power standard, the requirement that only economic factors be considered in judging the legality of a merger, and the introduction for the first time of an efficiency defense in a Section 7 proceeding. It is demonstrably clear from the legislative histories of Section 7 and its 1950 amendment, that Congress had more in mind than economic efficiency when it passed these laws. There is a great deal of social and political judgment encompassed in Section 7, and economic efficiency is but one element. Because Section 7 seeks to preserve a competitive marketplace by retarding growth by acquisition and merger, it fosters growth by healthy competition. By diminishing a firm's ability to acquire market share by merging with a competitor, Section 7 preserves the ability of new firms to enter markets and of small, efficient firms to expand. The National Grocers Association opposes S.2160, additionally, because it does not believe that economic efficiency is or should be the sole light by which our antitrust policy is guided.

Mr. Chairman, I would like to comment briefly on Section 5 of S.2022. I should note that the N.G.A. Board has taken no position on the other subjects addressed by that bill and, therefore, I will not comment on them.

Section 5 of S.2022 would also introduce the efficiency defense into merger analysis, albeit by somewhat more oblique means than S.2160. N.G.A. agrees with the U.S. Supreme Court that efficiencies cannot save an otherwise unlawful merger. The Federal Trade Commission and the Antitrust Division of the Department of Justice have both stated that efficiencies will be considered in their determinations of whether to challenge a merger. Once challenged, however, the agencies do not recognize an efficiency defense. N.G.A. believes this a proper approach.

Section 5(b) of this bill would seem implicitly to require both the F.T.C. and the Antitrust Division to publicly reveal their reasons for not challenging the multitude of mergers that are allowed to proceed without government interference. Those reasons are not presently published by the agencies, and I doubt that this proposal would increase the quality of their administration of the law. Finally, I would note that the certification procedure contained in Section 5(b) will likely lead to increased costs in merger law enforcement without offsetting benefits. Even though the aims of the two bills are vastly different, this bill, like S.2160, would tend to rigidify antitrust enforcement. The National Grocers Association opposes this rigidity for the reasons already stated in connection with S.2160.

* * *

By questioning the assumption that all mergers are good, neither N.G.A. nor I imply that they are all bad. At issue is the form of government merger policy that will maintain a free and fair marketplace. We believe that the present language of Section 7 interpreted as it was intended, together with consistent enforcement when a merger threatens to substantially lessen either price or non-price competition, will achieve that objective.

Mr. Chairman, I would be pleased to answer any questions that you or other members of the Committee may have.

The **Chairman**. Thank you very much. We appreciate you witnesses coming here today and testifying. We wanted to give an opportunity to anyone who cared to make a statement on this matter.

Is there anything else any of you want to say?

[No response.]

The **Chairman**. Your entire statements will go in the record, and we appreciate your presence and thank you for your testimony.

We now stand adjourned.

[Whereupon, at 12:27 p.m., the committee was adjourned.]

MERGER LAW REFORM—S. 2022 AND S. 2160

WEDNESDAY, MAY 21, 1986

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 10:24 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Strom Thurmond (chairman of the committee) presiding.

Also present: Senators Grassley, Heflin, and McConnell.

Staff present: Kenneth Starling, chief antitrust counsel; Alice Milder, counsel; and Karen Kremer, minority counsel.

OPENING STATEMENT OF CHAIRMAN STROM THURMOND

The CHAIRMAN. The committee will come to order.

I regret we are a little delayed in getting started, but I had an Armed Services meeting I had to go to and also had to testify over in the House a little while ago.

Today the committee is holding its third hearing on proposals to revise merger law and procedures. One of these proposals is S. 2160, which I have introduced on behalf of the administration as part of a comprehensive package of antitrust reforms. The administration recommends that Congress change the substantive legal standard governing mergers to bring it into line with current enforcement policies, to give proper weight to the cost-savings flowing from some mergers, and to take full account of the force of foreign competition. Also before the committee is another set of proposals, which was introduced by the distinguished Senator from Ohio, Senator Metzenbaum.

Our witnesses today include the Chairman of the Federal Trade Commission, Mr. Daniel Oliver. As you know, the FTC shares with the Justice Department the responsibility for enforcement of the merger laws.

Following Chairman Oliver, we will hear from a panel which includes a former member and a former top antitrust official of the FTC. On the panel will be Thomas J. Campbell, professor of law at Stanford University and former Director of the FTC's Bureau of Competition; Robert Pitofsky, dean of the Georgetown University Law Center and former member of the Federal Trade Commission; James P. Melican, general counsel of International Paper Co., and member of the Council of the ABA's Antitrust Section; and Timothy Roth, professor and chairman of the economics and finance department at the University of Texas at El Paso.

We appreciate the time, work and travel the witnesses have devoted to our hearing on these important antitrust proposals, and we look forward to their testimony.

We will begin with Chairman Oliver of the Federal Trade Commission.

Mr. Oliver, if you will come around.

You may proceed. Mr. Oliver, I am just wondering if you could put your entire statement in the record and take 5 minutes and give us the thrust of it. If you can give it to us, sometimes if you do it in your own words it is simpler and is more comprehensive.

STATEMENT OF HON. DANIEL OLIVER, CHAIRMAN, FEDERAL TRADE COMMISSION, WASHINGTON, DC, ACCOMPANIED BY TERRY WINSLOW, ACTING DIRECTOR OF THE BUREAU OF COMPETITION; AND DAVE SCHEFFMAN, ACTING DIRECTOR OF THE BUREAU OF ECONOMICS

Chairman **Oliver**. Senator, I would be delighted to.

Mr. Chairman and members of the committee, I am pleased to be here. This is my maiden voyage as Chairman of the Federal Trade Commission, Mr. Chairman, and I am delighted to make it before your committee.

I have with me on my right Terry Winslow, the Acting Director of the Bureau of Competition; and on my left is Dave Scheffman, the Acting Director of the Bureau of Economics.

I would like to testify on behalf of the Federal Trade Commission concerning S. 2160, the Merger Modernization Act of 1986. This legislation would amend section 7 of the Clayton Act to clarify the liability standard in merger cases.

Let me just briefly summarize the written statement which you have already received. The FTC supports S. 2160 and recommends that Congress enact it. Section 7, in its present form, is workable but imprecise. The uncertainties of its language complicate business planning and create a continuing risk that merger enforcement will be applied by the courts in a way that injures consumers. We therefore favor the greater precision of the bill before you.

The proposed bill makes three major changes in section 7. It clarifies the substantive standard of anticompetitive harm; it clarifies the degree of certainty that one must have in predicting such harm, and it delineates specific factors that must be considered when making those determinations. Let me briefly take these three points in turn.

The heart of this act is its definition of the harm that must be shown before a merger can be found illegal. The bill states that a merger is to be judged exclusively in terms of the effect it is likely to have on the ability of firms to "exercise market power." Market power is then defined as "the ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time."

This is a clear improvement over the current language of section 7. That simply prohibits merger, the effect of which "may be substantially to lessen competition, or to tend to create a monopoly." Section 7 does imply some economic goal, but it does not make clear just what sort of evidence the courts should look to in determining whether there may be a "substantial" lessening of competition.

As a result, the courts have not always focused on the likelihood of injury to consumers in their assessment of mergers. The *Brown Shoe* decision of 1962 is a good example. In the horizontal aspects of that case, the Supreme Court tried to assess the threat to competition by focusing primarily on the structural characteristics of the market. It looked at concentration, market shares, and especially the combined market shares of the merging firms.

Yet we now know—modern economists are virtually unanimous in saying—that the workings of competition are more complex. Even if an industry is concentrated, for example, and the firms can raise prices, they will be unable to do so successfully as long as other firms are likely to enter the market. For a merger to be harmful in these circumstances, the market must be protected by entry barriers. There must, in other words, be market power.

Market power is thus the ultimate test of whether harm to competition is likely. The proposed bill explicitly makes this the center of the analysis. It thus avoids the risk that the courts—or the antitrust—agencies will again give excessive weight to other factors.

This brings me to the second major change that the proposed amendment would make—that is, to replace the "may be" and "tend to" language in the current section 7 with a requirement that there be a "significant probability" that a merger will lead to the acquisition of market power. The new standard is intended to reflect Supreme Court case law by emphasizing that section 7 is not to be used to prohibit a merger on the mere possibility that it will result in anticompetitive effects.

The third and final change in the proposed amendment is the enumeration of six specific factors that the courts must consider when judging a particular merger. This list is nonexclusive, since the amendment also directs the courts to consider any other evidence relevant to an increased ability to exercise market power.

We support this change. The six factors all go to the assessment of whether the merger is likely to lead to an increased risk to consumer welfare Although each specific factor may not be entitled to equal weight in every case, and although some factors may not be relevant to the exercise of market power in every situation, their enumeration should help unify the judicial interpretations of section 7. In addition, the Commission does not believe that codification of these specific factors will require the government to conduct an impossibly complicated, open-ended evaluation of every transaction.

To sum up, we believe that the proposed legislation represents a constructive step in the ongoing effort to achieve a rational enforcement policy under section 7. It is in the mainstream of economic thought, and in the interests of American consumers.

Mr. Chairman, I would now be pleased to address any questions that members of the committee might have.

[Prepared statement follows:]

PREPARED STATEMENT
of
DANIEL OLIVER
CHAIRMAN
FEDERAL TRADE COMMISSION
before the
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE
WASHINGTON, D.C.
MAY 21, 1986

Mr. Chairman and members of the Committee, I am pleased to have the opportunity to testify on behalf of the Federal Trade Commission concerning S. 2160, the "Merger Modernization Act" of 1986. This legislation would amend Section 7 of the Clayton Act to clarify the liability standard in merger cases.

Section 7 of the Clayton Act, in its current form, has been on the books for over 25 years now. Nevertheless, the exact focus of Section 7's test of illegality remains elusive. The Supreme Court has not issued an opinion on the merits in a Section 7 case in 12 years. And lacking extensive guidance from the Supreme Court, the lower federal courts have reached diverse merger decisions, some of which have shown insufficient concern for the interests of consumers in lower prices and increased production or for the potential efficiency gains that mergers can involve. In the meantime the economic learning applicable to antitrust issues has advanced rapidly. The Supreme Court has relied increasingly on this new learning in its opinions in other areas of antitrust law. In these opinions, the Court has made it clear that antitrust is properly concerned with the promotion of competition and consumer welfare and the advancement of economic efficiency.[1]

The current FTC Statement on Horizontal Mergers and the Department of Justice Merger Guidelines (hereinafter referred to jointly as the "Guidelines"), together with recent FTC administrative opinions, attempt to bring merger enforcement policy into line with the current economic understanding by emphasizing the interests of consumers in lower prices, greater output, and enhanced efficiency. We believe the Guidelines and FTC merger opinions reflect the proper approach to merger enforcement policy and represent steps in an on-going process that has brought greater rationality to antitrust law in general and to merger enforcement in particular.

We believe that enactment of the Merger Modernization Act is a logical next step in this process. Its enactment should contribute to the development of Section 7 law that will recognize and serve the interests of consumers because it is guided by the best modern understanding about mergers and the way markets work. Although current economic thinking has become more prevalent in the judicial resolution of Section 7 cases, under the present statute the courts sometimes decide merger cases according to criteria that may injure rather than promote consumer welfare. Under the proposed amendment, Section 7 enforcement would unquestionably be governed statutorily by the same guiding principles as those underlying the Guidelines with their emphasis on the use of economic analysis to determine a merger's likely impact on consumer welfare.

The proposed amendment makes three major changes: (1) it clarifies the substantive standard for the requisite anticompetitive harm; (2) it clarifies the required level of certainty by imposing a requirement that there be "significant probability" that a merger will have anticompetitive effects before it can be deemed illegal; and (3) it delineates specific factors that must be considered in assessing the legality of a merger.

THE SUBSTANTIVE STANDARD FOR ILLEGALITY

The heart of the Merger Modernization Act is its definition of the harm that must be shown before a merger can be found illegal. The bill makes it explicit that a proposed merger is to be judged exclusively in terms of the effect it is likely to have on the ability of firms operating in the relevant market to "exercise increased market power." Market power is defined as "the ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time."

Section 7's current language, which prohibits mergers, the effect of which "may be substantially to lessen competition, or to tend to create a monopoly," established a vague substantive standard. The language does, however, employ economic criteria. This indicates that it was intended to be applied to preserve competition and avert monopoly in particular markets.[2] But in the past these economic concepts have sometimes been interpreted quite differently from the way we interpret them today. Thus, even to the extent the courts have acknowledged competition and consumer welfare as the proper objectives under Section 7, they have not always reached consistent results because they have sometimes relied on now outdated economic thinking.

The effort to establish a predictable and economically sensible liability standard based on Section 7's current language has been hindered by judicial precedent that based decisions in merger cases on then-prevailing economic thinking. This problem can be traced to the Supreme Court's first opinion interpreting Section 7 as amended in 1950. In the Brown Shoe case of 1962,[3] the Supreme Court did not choose to focus on the promotion of competition and consumer welfare, certainly not as those concepts are now understood. Rather, the Court's decision was consistent with the prevailing economic thinking of the day, which held that increased concentration was virtually per se anticompetitive. In assessing the horizontal aspects of the merger before it, the Court thus chose to rely heavily on the combined market shares of the merging retail stores. In subsequent cases, the Court relied primarily on concentration in the affected markets, together with other factors that had little to do with the creation of market power, to gauge the competitive effects of mergers. Other relevant economic factors were essentially ignored. The Court made "substantial" market shares and high four-firm concentration ratios virtually conclusive proof of illegality.

The Supreme Court has since accorded more importance to other economic factors,[4] but it has not clarified to any great extent the specific nature of the competitive harm addressed by the merger laws. Moreover, Section 7 has been and continues to be interpreted by some lower courts in a manner with which we disagree. Efforts to refine and update merger standards through the issuance of enforcement agency guidelines and through the adjudication of individual cases are slow and can result in a diverse, if not inconsistent, body of case law.

Enactment of the proposed legislation's test of illegality, on the other hand, would immediately make it clear that Section 7's only objective is the promotion of consumer welfare by preventing mergers that are likely to increase the ability to maintain supracompetitive prices to consumers through monopolization or anticompetitive collusion in a relevant market.[5] The proposed test of illegality would require resolution of the question of whether, as a consequence of the merger, one or more firms in an industry would be in a better position to maintain prices above the competitive level. The proposed legislation would thus affirm that Section 7 is intended to protect competition for the benefit of consumers rather than to benefit particular competitors.

Although illegality under the proposed amendment is defined in terms of increased ability to maintain supracompetitive prices, it will not depend on proof that anticompetitive mergers actually will result in higher prices. The proposed amendment seeks to identify, prospectively, those mergers that are likely to result in the ability to maintain supracompetitive prices.[6] But one cannot always know in advance how increased market power will actually be used. Once the likely ability to charge supracompetitive prices is established, it does not matter whether this market power might instead be used, for example, to retard innovation, suppress variety or quality, divide markets, or allocate customers.[7] Thus, if the requisite likely increase in market power is established, but it is deemed more probable that the anticompetitive effect will manifest itself in the form of a conspiracy to divide markets, or in the form of a dominant firm's effort to suppress innovation, the merger would still be illegal. However, unless a merger results in sufficient market power to give one or more firms the ability to raise prices above competitive levels, it cannot have any of these other anticompetitive consequences.

Until now I have at least implicitly been addressing myself to the competitive implication of horizontal mergers between competitors. But other kinds of mergers would remain subject to scrutiny under the proposed test of illegality. For instance, mergers that injure potential competition would remain within the reach of the amended Section 7 when, by eliminating a threat of entry, they result in the creation of sufficient market power to enable firms in the relevant market to raise prices. When this is a likely outcome of a merger that eliminates a potential competitor then, as we understand the proposed legislation, the merger would be illegal. But when the elimination of a potential entrant would not enhance the market power of incumbent firms, the merger would not be illegal, and that is as it should be. Similarly, the proposed standard also permits enforcement against vertical and conglomerate mergers that constitute a significant threat to consumer welfare. Vertical and conglomerate mergers, particularly conglomerate mergers, in fact rarely pose such a threat, but nothing in the proposed test of illegality would foreclose prosecution of an appropriate case.[8]

For these reasons, the Commission favors enactment of the test of illegality defined in the proposed legislation.

THE SIGNIFICANT PROBABILITY REQUIREMENT

This brings me to the second major change that the proposed amendment would make, that is to replace the "may be" and "tend to" language in current Section 7 with a requirement that there be a "significant probability" that a merger will lead to the exercise of market power. The effect of this proposed change is to clarify the degree of certainty required in what is necessarily a predictive judgment. The new standard is intended to reflect more accurately Supreme Court case law and current Section 7 enforcement policy by emphasizing that Section 7 is not to be used to prohibit a merger on the mere possibility, rather than the significant probability, that the merger will result in anticompetitive effects.

The proposed amendment can be seen as simply an effort to bring the current statute into conformity with Supreme Court pronouncements and with its 1950 legislative history, both of which have specified that illegality is to depend on a showing of a "reasonable probability" of a substantial lessening of competition.[9] Although both terms are somewhat imprecise, we see no practical difference between "reasonable probability" and "significant probability."[10]

SPECIFIC ENUMERATED FACTORS

The third major change in the proposed amendment is the enumeration of six specific factors that courts must consider in assessing whether there is a significant probability that a merger will substantially increase the ability of firms in the industry, acting either unilaterally or collectively, to exercise market power.[11] The list is non-exclusive, however, since the proposed amendment also directs the courts to consider any other evidence relevant to the increased ability to exercise market power. The six specific factors all go to the assessment of whether the merger is likely to lead to monopolization or facilitate collusion. While each specific factor may not be entitled to equal weight in every case, and while some factors may not always be relevant to the potential exercise of market power, their enumeration should help unify judicial interpretation of Section 7 and help clarify to private parties contemplating a merger the nature of the required inquiry into the likely increase in the ability to exercise market power.

We do not believe that codification of these specific factors need necessarily require the government to conduct an impossibly complicated, open-ended evaluation of all of the factors in an effort to predict the outcome of a highly complex transaction before it has occurred. In its recent merger decisions, the Federal Trade Commission has used presumptive tests of illegality.[12] The use of such rebuttable presumptions eliminates the need to conduct an unbounded, open-ended inquiry into every aspect of a merger's probable competitive effect. We do not interpret the proposed legislation as preventing us from continuing to use and develop these and other presumptive tests so long as they are consistent with the legislation's basic standards. Nor would the courts be constrained from doing so. The continued development of presumptive tests is an appropriate part of the evolution of a more sound merger policy.

CONCLUSION

To sum up, therefore, we believe that the proposed legislation represents a constructive step in the ongoing effort to achieve economically rational enforcement policy under Section 7. It is in the mainstream of current economic thinking about markets and merger enforcement. We believe that its enactment is desirable because it would be in the interest of American consumers. I would now be pleased to address any questions that members of the Committee might have.

FOOTNOTES

1 See, e.g., Matsushita Electric Industrial Co. v. Zenith Radio Corp., No. 83-2004 (Mar. 26, 1986); Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 105 S. Ct. 2613 (1985); Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984); NCAA v. Board of Regents, 104 S. Ct. 2848 (1984); Reiter v. Sonotone Corp., 442 U.S. 330 (1979); Broadcast Music, Inc. v. Columbia Broadcasting, 441 U.S. 1 (1979); and Continental T.V. Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

2 Section 7 is expressly concerned only with mergers that "lessen competition" or "tend to create a monopoly" in a particular "line of commerce" and "section of the country."

3 Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

4 United States v. General Dynamics Corp., 415 U.S. 486 (1974).

5 Mergers that lead to monopolies or to dominant firms are unlikely to be consummated today, so that the focus of the inquiry in most litigated cases would be on the increased likelihood of the exercise of market power through collusion among firms in the industry. Mergers that are likely to lead to monopolies or to dominant firms pose the most serious antitrust problems. However, since the institution, in the 1970's, of premerger clearance procedures under the Hart-Scott-Rodino Act, mergers with serious antitrust problems are frequently identified in advance. Either the problems are cured by divestiture or other means agreeable to the enforcement agency or else, in the face of certain government challenge of the unconsummated merger, the parties abandon their merger plans. This is probably one of the main reasons why relatively few merger cases are likely to reach the Supreme Court in the 1980's. Because of the premerger procedures, the government today will infrequently be in the position of challenging a consummated merger, as was the case in the 1960's and early 1970's, though private plaintiffs do sometimes seek to have such mergers undone. The issue of a competitor's standing under Section 7 will be considered by the Supreme Court next term in Monfort of Colorado v. Cargill, Inc., 761 F.2d 570 (10th Cir. 1985), cert. granted, 106 S. Ct. 784 (1986).

6 The proposed standard does not expressly prohibit mergers that create monopsonistic buying power -- the power to force prices below competitive levels. Although such mergers may be rare, we interpret the proposed test of illegality as being intended to reach all mergers that increase market power, including those likely to result in monopsonistic market power.

7 Thus, in this context, the phrase "ability to maintain prices above competitive levels" should be read as referring to all competitive restraints. If price competition is hindered by governmental regulation or institutional forces such as the third party payment system in the health care industry, nonprice competition may still be significant and should be preserved.

[8] The proposed legislation, as we understand it, would not preclude the Commission from prosecuting an anticompetitive vertical merger. For instance, the Commission recently accepted a consent agreement in a vertical merger case. See, In re Occidental Petroleum Corp., et al., Consent Agreement Accepted, 51 Fed. Reg. 9060 (March 17, 1986).

[9] The Supreme Court has frequently articulated the required showing in terms of "reasonable probability." See, e.g., United States v. Marine Bancorporation, 418 U.S. 602, 622-23 (1974); United States v. Citizens & Southern National Bank, 422 U.S. 86, 122 (1975).

[10] It has been suggested that the proposed "significant probability" amendment would prevent courts or future enforcement agencies from invoking an "incipiency" standard to block a merger. However, like "may be" or "tend to," "significant probability" is prospective and predictive in its application and thus necessarily applies an incipiency approach to merger analysis. Indeed, it is hard to imagine any other practical way to review unconsummated mergers.

[11] The six enumerated factors are (1) the number and size distribution of firms and the effect of the acquisition thereon, (2) ease or difficulty of entry by foreign or domestic firms, (3) the ability of smaller firms in the market to increase production in response to an attempt to exercise market power, (4) the nature of the product and terms of sale, (5) conduct of firms in the market, (6) efficiencies deriving from the acquisition.

[12] See, e.g., In re Hospital Corp. of America, 3 (CCH) Trade Reg. Rep. ¶ 22,301 (FTC 1985); In re Weyerhaeuser Co., 3 (CCH) Trade Reg. Rep. ¶ 22,315 (FTC 1985).

The CHAIRMAN. Thank you very much, Mr. Oliver.

Mr. Oliver, I have a few questions here I would like to propound to you. Would you say that the economic learning that applies to a merger analysis has evolved a great deal since the last Supreme Court decisions on merger law?

Chairman OLIVER. Has evolved what? I am sorry, Mr. Chairman.

The CHAIRMAN. On merger law.

Chairman OLIVER. Well——

The CHAIRMAN. Did you understand the question?

Chairman OLIVER. I did not hear the word.

The CHAIRMAN. Would you say that the economic learning that applies to merger analysis has evolved a great deal since the last Supreme Court decisions on merger law?

Chairman OLIVER. Well, one of the main decisions, the latest decision of the Supreme Court took place in 1974. That was the *General Dynamics* case which did consider certain of the aspects that are reflected in this legislation. Since that time, there has been further refinement in the economic understanding of mergers, primarily along the lines cited in this legislation and discussed in the guidelines put out by the Department of Justice and the statement on mergers put out by the Federal Trade Commission.

The CHAIRMAN. A great many people feel that the economic situation has changed a great deal since the Supreme Court decision of 1974. I just wondered how you felt.

Chairman **Oliver**. Well, I think there has been considerable development in the law over the last 10 or 12 years.

The **Chairman**. Some people who were opposed to mergers years ago seem more inclined now to favor them on account of competition with foreign countries and other reasons. And I just wondered how you felt.

Chairman **Oliver**. Well, I think that there is a tendency to look at a global market, a market that includes foreign competition in the United States, instead of looking only at domestic firms. I think that the way we analyze the shape and size of the market has changed over the years. Yes, Mr. Chairman.

The **Chairman**. If Congress did not enact the administration's proposal but left the courts to be guided by the Justice Department and FTC guidelines, how long would it take for the courts to build modern economic learning into their analysis of mergers?

Chairman **Oliver**. Mr. Chairman, I do not know the answer to that question. It would take, I suppose, a considerable length of time for the courts to accept completely the factors and the guidelines in the FTC's horizontal statement, which is reflected in the legislation.

The problem is that during the time that the courts develop that law and adopted it, there would be uncertainty in the community as to exactly what standard might apply.

I think it is probably fair to say that much of the understanding that is reflected in this legislation has already been accepted by most of the courts, but not necessarily by all of them. And because it has not been accepted by all of them, there is uncertainty as to what any particular court might say in a particular situation.

The **Chairman**. Mr. Oliver, in your view is the level of certainty required to prevent a merger under the administration's proposed merger any different from the level of proof required by the FTC today?

Chairman **Oliver**. I think that the proof required and the factors that are looked at by the Federal Trade Commission today are the factors delineated in the legislation that is being proposed and that are expressed both in the Department of Justice guidelines and the FTC's horizontal statement. Those are the factors that the Commission looks at, and they will continue to look at those factors.

But it would be useful, I believe, to be sure that the courts would be required to consider those same factors as they consider the various cases brought by the Department of Justice, by the Commission, or by private plaintiffs.

The **Chairman**. What I was trying to get at is whether you feel that the level of certainty required to prevent a merger under the administration's proposed merger is any different from the level of proof required by the FTC?

Chairman **Oliver**. The proposed legislation has the term "significant probability" in it, and my understanding is that the courts today probably use a standard that relates to or is similar to significant probability. In the past some of the cases seemed to have a standard that was much lower, a "mere possibility." I believe that the courts today probably will also have a standard which is more like significant probability than mere possibility.

But again, the point would be to try to ensure that the courts would have to use the hiqher standard than a lower standard.

The CHAIRMAN. What is the standard of the FTC?

Chairman OLIVER. The standard the FTC uses is more like significant probability than mere possibility, but I am not sure exactly what wording the Commission uses today. Indeed, the terms inevitably introduce a matter of judgment.

My understanding is that even the courts today require something that is more like significant probability than mere possibility.

The CHAIRMAN. Is there anything else you would like to say now?

Chairman OLIVER. No, Mr. Chairman. I appreciate the opportunity that I have had to respond to your questions and request that my longer statement be entered into the record.

The CHAIRMAN. I think that is all the questions I have. Thank you very much for your appearance.

Chairman OLIVER. Thank you, Mr. Chairman.

The CHAIRMAN. You may wish to stay and hear these other witnesses.

Chairman OLIVER. Yes, Mr. Chairman.

The CHAIRMAN. Thank you.

Now we will ask the other members to come around. Professor Thomas J. Campbell, if you will sit on the right here. Next is Mr. Pitofsky, if you will sit next to him. Next is Mr. Melican and next is Mr. Roth. Is Mr. Roth here?

Mr. ROTH. Yes.

The CHAIRMAN. Would you gentlemen want to take 5 minutes each to give the thrust of your statement, and we will put your entire statement in the record. It will be available to the full committee.

But you just take from 3 to 5 minutes to give us the thrust of it. You do not have to go into detail because your entire statement speaks for itself. I would just like to get your main thoughts expressed in a few words.

Mr. Campbell, you may proceed.

STATEMENT OF PANEL CONSISTING OF THOMAS J. CAMPBELL, ASSOCIATE PROFESSOR OF LAW, STANFORD UNIVERSITY SCHOOL OF LAW, STANFORD, CA; ROBERT PITOFSKY, PROFESSOR OF LAW AND DEAN, GEORGETOWN UNIVERSITY LAW CENTER, WASHINGTON, DC; JAMES P. MELICAN, VICE PRESIDENT AND GENERAL COUNSEL, INTERNATIONAL PAPER CO., NEW YORK, NY; AND TIMOTHY P. ROTH, PROFESSOR AND CHAIRMAN, DEPARTMENT OF ECONOMICS AND FINANCE, UNIVERSITY OF TEXAS, EL PASO, TX

Mr. CAMPBELL. Mr. Chairman, thank you so much. Thank you for inviting me here today.

One of the reasons, I believe, I might have been asked to speak today is because of my experience at the Federal Trade Commission during a time when there were more merger applications filed than at any other time in our history, and during which time several of the very largest mergers were investigated. I will try to draw upon that experience in my testimony today.

In general, Mr. Chairman, I strongly endorse the Merger Modernization Act of 1986. Thus, responsive to your inquiry that I simply go to the thrust, let me emphasize the one or two points on which I disagree with the bill.

The most important point, I believe, is that the efficiencies defense ought not be made part of the law. The reason for that stems in part from my own experience and in part from my belief as to the inability of Federal courts to measure efficiencies accurately.

During my time at the Federal Trade Commission, Mr. Chairman, virtually every merger—and there were hundreds—virtually every one spoke of efficiencies. Never was one able to measure the efficiencies. That is not a surprise. Economic efficiencies are very difficult to measure in advance. In my longer statement I emphasize some of the precise economic problems with measuring efficiencies.

Why is measurement a problem? Because the way the Merger Modernization Act of 1986 is drafted, a court must not only satisfy itself that efficiencies exist, it must also try to measure them so as to answer the question whether the efficiencies offset the market power that a merger might lead to.

The determination of market power can be made on the basis of the factors that are in the bill. My worry is that the bill permits a court to make an open-ended judgment. In the case of a merger that otherwise leads to market power, the judge may allow it because of efficiencies. You will essentially be giving to the judge unreviewable discretion to allow a merger which would otherwise lead to market power.

By way of an analogy, if we had a burglary statute, it might define burglary as breaking and entering a domicile by night. The judge could enforce that; he could ascertain was there a breaking, was it at night, was it a domicile. But if in addition you say, nevertheless, it shall not be burglary if the television set was worth more to the thief than it was to the homeowner, you leave the judge an opportunity to approve what would otherwise violate the law, and no real standards to review his judgment.

The two other brief points: I applaud the phraseology of the Merger Modernization Act in its emphasis on potential entry from abroad and potential competition from smaller firms in the market—I would suggest the word "smaller" be changed to "other," but that is not a major point.

This bill is an improvement on the Justice Department merger guidelines which treat competition from overseas as though it was an important factor even in the context of a voluntary restraint, an import quota, or an orderly marketing agreement. Economically, however, in the presence of a percentage voluntary restraint, orderly marketing agreement, or quota, there is no effective competition from overseas. Thus, I applaud the phrasing in this bill.

Finally, I have read the American Bar Association's submitted testimony suggesting that "reasonable probability" is a more appropriate phrase than "significant probability." I concur in that judgment for two grounds: First, significant probability is more in accord with case law; second, using "reasonable" rather than "significant" would avoid an interesting, perhaps academic, question of what application the concept of statistical significance might have in this context. I note that as a matter of common social science inference, an event is statistically significant if it could have occurred by chance no more than 1 in 20 times. I do not believe that is what the drafters of the bill intended.

I thank the chairman.

[Prepared statement follows:]

TESTIMONY
ON S. 2160, "THE MERGER MODERNIZATION ACT OF 1986"

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BEFORE THE SENATE JUDICIARY COMMITTEE
WEDNESDAY, MAY 21, 1986

OUTLINE OF TESTIMONY

1. Executive summary
2. Personal qualifications
3. Desirability of law over guidelines
4. The international competition rationale for change
5. The efficiency of mergers rationale for change
6. Particular suggestions
    a) eliminate efficiencies defense
    b) emphasize potential foreign entry
    c) include expansion by large as well as small firms
    d) time periods

Executive Summary

There is much potential benefit from legislation in the merger field. The Justice and FTC Guidelines are not adequate substitutes for statutory improvements, which can bring merger law into consistency with economic learning and experience, and also narrow the variability of potential outcomes in U.S. courts. However, the argument that these changes, in allowing more mergers, will measurably improve the United States competitive position with the rest of the world, is not compelling. Nor is it valid that all mergers, or the vast majority of them, are efficient. But whole categories of mergers may be identified where there is no anticompetitive risk. These should, and will be, allowed by the draft legislation.

Four specific recommendations are offered: a) eliminate the proposed efficiency defense where the merger is otherwise condemnable; b) recognize appropriately broad markets, but exclude foreign capacity when there are percentage import quotas or VRA's in force; c) in defining a market, take account of potential fringe expansion from large firms as well as small firms (the bill only mentions small firms); and d) allow courts to condemn mergers that lift price even for only a short period of time, especially where the industry is large and the price rise great.

2. Personal qualifications

I am very grateful for the Committee's invitation to testify today.

The part of my background most relevant to my testimony is that from 1981 to 1983, I served as Director of the Bureau of Competition of the Federal Trade Commission. During that interval, the FTC surveyed a greater number of mergers than at any previous time in its history. Among the very large mergers which the Bureau of Competition investigated under my direction were Mobil's attempt to acquire Marathon (opposed by the FTC), Gulf's attempt to acquire Cities Service (opposed by the FTC), B.F. Goodrich's attempt to acquire Diamond Shamrock (opposed by the FTC), LTV's attempt to acquire Grumman (opposed by the FTC), and several mergers involving the Hospital Corporation of America (also opposed by the FTC). The largest merger approved by the FTC during this time period was Conagra's acquisition of Peavey, a merger in the grain industry that was approved only following divestiture of major assets by Conagra; U.S. Steel's acquisition of Marathon (following Mobil's unsuccessful bid); and Occidental's acquisition of Cities Service (following the failure of Gulf's attempt).

Prior to my position at the FTC, I served as law clerk to Justice Byron R. White of the U.S. Supreme Court, law clerk to Judge George E. MacKinnon of the U.S. Court of Appeals for the District of Columbia Circuit, White House Fellow in the Office of the Chief of Staff during the Administration of President Carter, and Executive Assistant to the Deputy Attorney General, Ed Schmults, during the Reagan Administration. I practiced law in Chicago from 1978-1980 with Winston & Strawn.

Presently, I hold the position of Associate Professor of Law at Stanford University. I teach courses in advanced antitrust law, microeconomics, international business transactions, and transnational law. My educational background includes a Ph.D. in economics from the University of Chicago in 1980 (with the highest fellowship award in the Department), and a J.D. (magna cum laude) from Harvard Law School in 1976, where I was an editor of the Harvard Law Review.

3. Desirability of law over guidelines

The 1982 Merger Guidelines of the Department of Justice were the single most important improvement in merger law since the Supreme Court's decision in United States v. General Dynamics, 415 U.S. 486 (1974). S.

2160 incorporates many of the teachings of those guidelines, and their 1984 revision, into law. It is useful that this be done, because the Guidelines by themselves do not have the force of law.

Adopting these measures as law will compel more consistent court rulings than are now possible under the Supreme Court's interpretation of section 7 of the Clayton Act. There is Supreme Court precedent for stopping mergers of practically any size, and without regard to much recent economic teaching and experience. See, e.g, United States v. Von's Grocery Co., 384 U.S. 270 (1966); United States v. Philadelphia National Bank, 374 U.S. 321 (1963). The objective of limiting the variability of possible judicial outcomes in merger cases is especially important to the extent that private parties (not bound by the Justice or FTC guidelines) have standing to bring actions under section 7 of the Clayton Act. This is an issue on which the Supreme Court may soon have new teaching. See Cargill v. Monfort of Colorado, 761 F.2d 570 (10th Cir., 1984), cert. granted, 106 S.Ct. 784 (1986).

Time and again, I heard from companies whose activities were under investigation, that they could willingly comply with almost any rule, so long as there was some clarity about what the rule was. Before the 1982 Justice Department Merger Guidelines and FTC Statement Concerning Horizonatal Mergers (June 14, 1982), there was evident misunderstanding in certain segments of the business community over what mergers were illegal, and would be opposed by the federal government. Had it been clear that the antitrust authorities and courts would stop the mergers, Mobil would not have sought to acquire Conoco and Marathon, Gulf to acquire Cities Service, or LTV to acquire Grumman, to name but a few. Much effort and resources were wasted in those efforts. What the guidelines did for federal prosecutorial discretion, S.2160 can do for the entire area of merger enforcement: increase predictability, and improve economic consistency.

Further, while S.2160 will undoubtedly lead to more mergers, I am convinced that economically harmful mergers, to the best of our ability to measure likelihood of harm, will continue to be disallowed.

4. The international competition rationale for change

It has been argued that the United States is suffering in international competition because of its strict merger rules. In order for this to be true, there would have to be evidence that our foreign competitors are able to achieve important economies of scale that are not possible in the United States.

I am familiar with no convincing evidence supporting this point. United States industries are characterized by plants as large as any of our foreign competitors'. Evidence is also lacking of economies of scope, or distribution, whereby our foreign competitors have achieved comparative advantage through larger size. In all the industries I studied during my time at the FTC (most particularly, petroleum, cement, aircraft, minerals, and health care), I was never presented with any evidence by parties seeking to merge that foreign competitors had achieved advantages over American firms by reason of easier merger standards. Since it would have been clearly in the parties' interest to present such evidence, I assume that there was none available.1/

5. The efficiency of mergers rationale for change

There are many explanations for merger activity. In the oil industry, the FTC produced a major report in response to Congressional request, whose preparation I oversaw. The 1982 FTC Report on Mergers in the Oil Industry identified tax advantages as one major reason for merger activity. The ability to expense anew the cost of acquiring petroleum reserves unavoidably made an oil company more valuable to an acquirer than in the hands of any incumbent management. The more recent report of the Bureau of Economics of the FTC, "Antitrust Policy for Declining Industries," October, 1985, notes several other non-efficiency motivations, applicable in many industries, not limited to oil:

> Other mergers are motivated by non-efficiency considerations. Some mergers, at least historically, have apparently occurred to achieve market power. Others may be intended to reduce tax liabilities, e.g., where one firm has profits and the other has losses, or where a firm in a mature industry wants

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1/As a teacher of international business law, I can point to other reasons for declining U.S. competitiveness in world markets which are much more plausible culprits than our restrictive merger laws. At the top of this list would be the effect of a strong U.S. dollar, and higher labor costs resulting from the Jones Act, Davis-Bacon Act, organized labor (including its effect on the unorganized sector), and mandatory employee benefits of various kinds.

> to reinvest earnings so that the owners can realize income as capital gains. Some mergers may occur because of incentives created by government regulatory policies, e.g., regulations that treat interfirm and intrafirm transactions differently. Also, some acquisitions occur simply because one firm, which disagrees with market forecasts, believes that another firm is underpriced; the acquisition may be essentially a financial investment.

Id. at 15-16, footnotes omitted.

There are undeniable instances where mergers do lead to efficiencies. One with which I became familiar was the acquisition of Beldridge Oil Co. by Shell Oil Co. Shell had deep oil recovery techniques lacked by Beldridge, and not readily available for hire. Beldridge had large amounts of deep oil reserves. Hence, the merger created real economic efficiencies.

Thus, mergers occur for many different reasons. Not all are to achieve market power. Not all are to achieve economic efficiency. But one does not need to believe that most mergers are efficient to support a narrowing of the range of enjoinable mergers. Substantial and useful narrowing is achieved by eliminating whole categories where market power is not possible. That, I believe, is the special accomplishment of S. 2160.

Whatever the motive for the merger might be, if it is not to achieve market power, it should be allowed. Antitrust law's objective is to deter the exercise of market power. *See* *Jefferson Parish Hospital District No. 2 v. Hyde*, 104 S.Ct. 1551, 1559-60 (1984)("the statute was especially intended to serve" the objective of preventing diminution in consumer welfare in the microeconomic sense); *see also*, *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979).

If not for efficiency, why allow a merger to occur? There are two answers. First--because government has no warrant to interfere. The burden of proof is upon government to justify an interference into private behavior, not for the individual to establish the worth of the activity. Second, it is very difficult for a court, antitrust official, or economist, to predict when efficiencies are likely to occur. It is relatively easy, however, to identify necessary preconditions for any possibility of anticompetitive consequences. In allowing mergers when these preconditions are not present, the possibility of efficiency-enhancing mergers is maximized--even in cases where we can discern no strong likelihood of such an occurrence.

6. Particular suggestions

In general, I applaud S. 2160. However, in one respect I see potential harm. And in several smaller respects, I have minor suggestions. I begin with the more serious area.

A. Eliminate the efficiences defense.

The troubling language is the following:

> In determining whether there is a significant probability that any acquisition will substantially increase the ability to exercise market power, the court shall duly consider all economic factors relevant to the effect of the acquisition in the affected markets, including . . . (vi) efficiencies deriving from the acquisition.

I will shortly suggest that efficiencies ought not be considered in this context. But at first, I wish to point out that, if, as I perceive, the design is that efficiencies be considered affirmatively, this language is quite dangerous. An improvement would be to remove (vi) from the list of considerations, and simply add one more sentence to state:

> Efficiencies deriving from the acquisition shall also be considered and, where sufficiently large, may offset a significant probability of a substantial increase in the ability to exercise market power.

The problem with the present draft is that efficiencies are made to be relevant only as they bear on the probability of substantially increasing ability to exercise market power. Efficiencies do nothing to ✓ reduce this probability. Indeed, they do the opposite.

Market power is the ability to sustain a price above marginal cost. See Landes & Posner, Market Power in Antitrust Cases, 94 Harv. L. Rev. 937 (1981). If marginal costs have been lowered by reason of efficiencies, then, at any price, the difference between price and marginal cost is heightened, not lessened. The definition is inescapable.

Further, efficiencies may cause the merged firms to acquire a larger share of the market than the two separate firms. If they are exercising market power, it will thus be felt over a broader share of the production. It is just this problem that led the Supreme Court in FTC v. Procter & Gamble Co., 392 U.S. 134 (1968), to count against Procter & Gamble its likely improvement in the efficiency of Clorox, the intended acquired company. See Judge Bork's criticism of this result in The Antitrust Paradox (1978) at 204.

If the Committee wishes efficiencies to count in favor of a merger, this language should be clarified. Otherwise, it may have the opposite of its intended effect.

However, I urge this Committee not to include the clause on efficiencies. Efficiencies may well stay part of the Justice Department's standards for exercising prosecutorial discretion. But this issue should not be given to a court to ascertain, for three important reasons.

First, efficiencies will be exceptionally hard to measure. And once measured, that number is to be compared against the welfare loss from the likelihood of exercising market power. Thus, two difficult calculations must be made: not merely the likelihood of efficiencies or a substantial increase in the ability to exercise market power, but the dollars and cents size of each increase. How else can one be compared against the other?

I base my conclusion that efficiencies will be difficult to measure on the types of efficiencies that were often argued to me in my tenure at the FTC. No calculations approximating precision were ever presented to me, though the firms had every opportunity and incentive to do so. Rather, efficiencies were most often argued to exist in terms of better management styles, synergies in production and distribution, and elimination of "excess" capacity. None was ever estimable.

As for measuring the size of welfare loss from market power, the most direct measure is to estimate the so-called "deadweight loss" of monopoly. This requires estimating the demand curve, the marginal revenue curve, and the marginal cost curve, and deriving therefrom the output and price under a model of market power. A "deadweight loss" or "welfare triangle" loss is then estimated.

One side of this triangle is measured by the difference between price and marginal cost. The other two sides are the demand curve and the marginal cost curve. Under certain assumptions, Professor Landes and Judge Posner have worked out a formula for this one side. It requires knowing the market shares of the merging firms, the elasticity of demand, and the elasticity of supply of the fringe firms. *See* Landes & Posner, *supra*, at 972 (equation 4)(estimating the increment in market power from a merger).

I attempted to use this formula in several merger cases within the Bureau of Competition. Whereas it was useful in setting outer boundaries, no degree of precision was ever achievable on the basis of the very best evidence prepared by the merging parties, and the Bureaus of Economics and Competition. The elasticities of demand, and of fringe supply, were never precisely obtainable.

Virtual impossibility of measurement, in two separate respects, is thus my first reason for urging the efficiencies defense be dropped.

Secondly, even if efficiencies and deadweight loss could be measured, economics creates a tradeoff between the two that the Committee may not approve.

What should be the rule where a merger creates efficiencies more than enough to offset the size of the deadweight loss, but not enough to force prices ~~down~~ lower, and output higher, than the competitive case? By hypothesis, there has been a net gain in social welfare as economists measure that term. *See* O. Williamson, "Economies as an Antitrust Defense: The Welfare Tradeoffs," 58 Am.Econ.Rev. 18 (1968). However, it is only the monopolist who has obtained the benefit of that increase. Consumers have suffered a net loss in economic welfare.

As I read the present draft of (vi), this case may well be allowed.

The Supreme Court's rule for condemnation of questionable behavior in antitrust has recently become: Is output less or greater, in comparison with competition? *See*, *e.g.*, *NCAA v. Board of Regents of the University of Oklahoma*, 104 S.Ct. 2948 (1984). Under such a standard, the hypothetical case should not be allowed.

If it is not the Committee's intent to permit such a merger, yet still to allow some consideration for efficiencies, there is a middle ground. The phrase "efficiencies deriving from the acquisition" could be changed to "efficiencies deriving from the acquistion that will lead to increases in output." Efficiencies must be such as to satisfy the court that output will be greater after the merger than before. If output is greater, the price must be less. Thus, the twin objectives of antitrust will be achieved. (Refer again to the NCAA case, where the Court condemned the television broadcast rule because it resulted in less output.)

However, it must then be recognized that major cost savings, indeed, will be required. I doubt very much that they would ever be achieved. The efficiencies must be such not only to outbalance the deadweight loss in total size, but actually to lower the price from an original competitive level. Fisher, Lande, and Vandaele have shown, in one simple model, that if demand elasticity is one, cost savings must be 100% for this result; that is to say, the efficiencies must be so great as to eliminate all cost of production! See A. Fisher, R. Lande, W. Vandaele, "Afterword: Could A Merger Lead to Both a Monopoly and a Lower Price," 71 Cal.L.Rev. 1697, 1704 (1983).2/

Third, any calculation and comparison of cost savings and deadweight loss must include a future prediction as well as a present estimate. An efficiency-creating merger will change the industry structure. If the efficiencies are real, we can expect that the merged firms will grow in market share, displacing the firms without access to such efficiencies. This will occur even without any further mergers.

If economies of scale are exhausted before the end of this growth, the ultimate cost savings could be much less than we would estimate simply by extrapolating

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2/For larger elasticities of demand, smaller cost savings would be sufficient, but they would still be quite large in absolute sense. Elasticity of demand is very seldom found in the range of 4, yet even assuming so high a number, the necessary cost savings would be in the order of 25% to insure that price would fall.

The Fisher-Lande-Vandaele calculations assume moving from perfect competition to dominant firm behavior. If the acquiring firm was already acting in a dominant fashion, the cost savings necessary to be sure that price fell would be less. Nevertheless, if the acquiring firm were already exhibiting market power, it would be a violation of section 2 of the Sherman Act for it to make the acquisition. Thus, the Fisher-Lande-Vandaele calculations are quite relevant.

from the initial cost savings.

At the same time, the size of the deadweight loss would grow. The larger the percentage of output under the control of the dominant firm rather than the competitive fringe, the closer an industry comes to resembling an absolute monopoly, which has the highest deadweight loss of any oligopoly model. See E. Mansfield Microeconomics: Theory and Applications 334-36 (4th ed., 1982)(the dominant firm oligopoly model). Of course, the cost savings might also grow (assuming economies of scale are not exhausted); but there is no guarantee that the deadweight loss would continue to be less than cost savings as the dominant, but more efficient, firm took over the industry. The former could rise disproportionately to the latter; for example, if demand were relatively inelastic in its earlier ranges.3/ There is no basis for assuming that the calculations of cost savings and deadweight loss initially made will continue in perfect proportion as the now dominant firm expands.

In simple terms, today's cost savings could turn into tomorrow's price rise as a merging firm achieves more market power. It is quite difficult for a trained economist to make useful predictions of this eventual effect, even if there were accurate figures for today's cost savings and deadweight loss.

The three foregoing reasons strongly support the conclusion that courts ought not be asked to estimate and compare efficiency gains and deadweight losses.

In practice, I am concerned that allowing a court to consider efficiencies will misdirect the relevant focus. In close merger cases, I suspect that a court will avoid definitively answering the question of whether market power will result. The presence of possible efficiencies will simply tip the balance against enjoining a merger. But it would be preferable to force the court to make the hard choice as to whether or not a merger is likely to lead to a substantial increase in market power, because efficiencies have nothing to say about the existence of market power.

This can be seen most clearly by asking a

3/ Dominant firms work their way backward along a demand curve. See Mansfield, supra. As the dominant firm grew in share, it would thus, for the first time be able to exploit this relatively inelastic portion of the demand curve.

hypothetical question. Suppose a court was convinced that an acquisition would, to a significant probability, substantially increase the ability to exercise market power. Would this Committee want a court, having determined that a merger will lead to a substantial increase in market power, to allow it anyway, because of some separate good the merger will accomplish? I think not. I derive that impression from the fact that the draft bill erroneously tries to make efficiencies a factor in deciding whether or not there is a substantial increase in market power, rather than listing efficiencies as a possible benefit for which the undesirable competitive effect is the price that must be paid. Efficiencies do not make market power go away.

No clause should be included in this new third paragraph unless the Committee is willing to have it be determinative in cases that otherwise would be stopped. So that is the case I posit. It evades the issue to say, let the court consider a factor "for what it may be worth."

Clause (vi) should be removed from the last paragraph of the proposed legislation. Efficiencies may still be considered by the antitrust enforcing authorities in their prosecutorial discretion.

If the Committee is of the view that efficiencies should nevertheless be considered favorably by courts, then a redraft of clause (vi) is required. At present, it may be read to have exactly the opposite effect intended. But I would urge the Committee to do more, and adopt the language suggested above requiring that efficiencies be considered only if they are so great as to be likely to lower price from the pre-merger level.

b) Emphasize potential foreign entry

S.2160 improves on the 1984 Justice Merger Guidelines in the area of measuring foreign competition. Clause (ii) directs a court to consider the ease or difficulty of entry by foreign or domestic firms. The legislative history should make clear that this standard is more open to consideration of foreign ability to produce than the 1984 Justice Merger Guidelines.

In that document, the Department states, "If shipments from a particular country to the United States are subject to a quota, the market shares assigned to firms in that country will not exceed the amount of shipments by such firms allowed under the quota." 49 Fed. Reg. 26,830 (1984). In the statement introducing the guidelines, the Justice Department states, "no foreign firm will be excluded from the market solely because its sales in the United States are subject to import quotas." 49 Fed. Reg. 26,826 (1984).

This is economically incorrect. Suppose foreign suppliers are subject to a percentage quota, or a percentage "voluntary" restraint agreement (VRA). Japanese auto manufacturers, for instance, might be limited to importing no more than 40% of the total cars sold in the United States. In this case, what market share should be ascribed to the Japanese, in order to determine whether a merger among American firms might lead to market power? The Justice Guidelines would say no more than 40%. The correct answer, however, is zero.

Under a percentage quota, Japanese imports exert no discipline against the pricing decisions of American firms. The normal reason for looking to foreign imports in determining market power is that, if American firms, having merged to a certain size, attempt to lift price, a flood of imports will undercut that effort. With percentage quotas, no flood can occur. Indeed, as price rises in America, the absolute in dollars or units level of Japanese imports must decrease so as not to exceed the set percentage of a smaller base.

With percentage quotas, therefore, the Japanese firms are made unwilling partners in a cartel. To keep price high, all cartel members are given an allocated quota on production. Here, the Japanese take their proportionate cut back as do the Americans.

The strength of S.2160 in this case is apparent. The existence of this kind of quota will figure in the calculation of the "ease or difficulty of entry by foreign . . . firms." That is to say, further entry in response to a price rise is impossible under a percentage quota. Perhaps the court will consider this under the next clause as well, "the ability of smaller firms in the market to increase production in response to an attempt to exercise market power." If the Japanese firms are the "smaller" firms, then they have no such ability, in the case of a percentage quota or VRA.

If the quota is not a percentage quota, but an absolute one, the effect I describe is still true, but diluted. As price rises, no more imports come in, but the share of the market represented by the Japanese will rise. This has some restraining influence on the American firms' ability to set price, though by no means as much as would be presented by an unconstrained sector with the same market share.

In the case of a tariff, domestic firms are given a collar within which they can lift price. If the domestic firms remain competitive, the price will not rise by the full amount of the tariff, and market price will, in equilibrium, be no higher than the domestic firms' marginal cost. The American share of the market will rise. But once this has occurred, the foreign firms can still exert their full influence on any further price rises that might be attempted by an American firm after a merger. Thus, the treatment of a tariff for purposes of foreign ability to restrain domestic firms' market power should be quite different from the treatment of either kind of quota.

S.2160 accommodates the difference between percentage quotas, absolute quotas, and tariffs. (The VRA or "orderly marketing agreement" should be analogized to one of the kinds of quota.) S.2160 allows for different types of restriction to be considered differently.

S.2160 will also require a court to consider how permanent is quota or VRA relief. No quota or VRA should be presumed to last forever. Nor can a quota-free environment be expected to persist. However, it will be difficult for a court to engage in such a prediction. Helpfully, virtually all of America's quotas and VRA's carry explicit termination dates, with no assurance of renewal.4/ A court will thus have some useful guidance in assessing the duration of a quota or VRA.

Nevertheless, the simplest rule would be to treat foreign production or capacity as within the market if there is no quota in place at the time of the merger; and to consider foreign production or capacity as no constraint on the market (or less of a constraint in the case of an absolute quota) if there is a quota in

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4/ Quotas and VRA's imposed against a specific country or specific industry have either come about as a result of action under section 201 of the 1974 Trade Act, 19 U.S.C. section 2251-3 (the "escape clause") or by Presidential negotiation. In the latter case, a termination date is always specified. In the former case, the statute itself provides that relief may not extend for more than five years, renewable by the President for another three years. Furthermore, an industry may not petition for relief again within two years of the end of a previous grant of relief. 19 U.S.C. section 2253 (h) & (j).

place. Such an approach would eliminate a major area of unpredictable guesswork on the part of courts. And it would also internalize upon U.S. industry in requesting relief, and the President in approving or negotiating for relief, the very real cost such relief bears upon the American consumer. A U.S. firm contemplating a domestic merger may well forestall a request for section 201 relief, rather than risk the increase in market share resulting from a quota against foreign products. ✓

c) Include expansion by large as well as small firms.

One small point deals with the phrasing of (iii): "the ability of smaller firms in the market to increase production in response to an attempt to exercise market power" (emphasis supplied). There is no need to limit this factor to smaller firms. It is true that the smaller firms will most often serve the function of a competitive fringe, but larger firms may also act in this way.

The foregoing case of foreign imports is such a case: the foreign manufacturer may well be larger than the U.S. manufacturer, yet will act like a fringe firm and increase output in response to an increase in U.S. domestic price.

Additionally, some useful economic work has identified that strong firms in the position of number three or four often act in a competitive way, rather than joining into a tacit cartel or price-follower pattern. See J. Kwoka, "The Effect of Market Share Distribution on Industry Performance," 61 Rev. Econ. & Stat. 101 (1979).

Thus, the simple suggestion I offer here is to change the word "smaller" to "other" in clause (iii).

d) Time periods

The bill measures market power as the "ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time." The phrase "significant period of time" is entirely appropriate. It allows a judge to consider shorter periods of time when the degree of harm is greater, either because the price rise is greater, or because the industry concerned is more important in terms of overall size and effect on the economy.

This degree of latitude is preferable to the

Justice Guidelines' approach, which uses one and two-year periods. If a merged firm could profitably lift its price for one year, but within that year existing productive and distributive facilities previously dedicated to other uses could be shifted over so as to drive the price back down, Justice disregards the effect. Similarly, if a merged firm could profitably lift its price for two years; but before the 24th month, new facilities would likely be built, or existing facilities requiring significant modification to produce the good in question would likely be so modified, once again Justice will disregard the harm in the interim.

This may be an appropriate approach in some cases, but it is certainly not appropriate in all. For example, a major price effect in steel or petroleum lasting eleven months would hardly be insignificant. It may be helpful for the legislative history to indicate the Congress' intent that a court will not be bound by any pre-established definition of what constitutes a "significant period of time." Rather, this term should be interpreted in each case, depending upon the likelihood and extent of harm to consumers.

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It is an honor to have been asked to offer my views on S.2160. The concept of the bill is excellent, and it ought to be enacted.

The CHAIRMAN. Thank you very much. Your entire statement is in the record. We appreciate your appearance.

Next is Robert Pitofsky, dean of the Georgetown University Law Center. We are very pleased to have you, Dean Pitofsky.

STATEMENT OF ROBERT PITOFSKY

Mr. PITOFSKY. Thank you, Mr. Chairman. I will try to be brief as well.

I do not believe there is any reason to amend section 7. While I think there are some attractive aspects of the proposed bill if we were going to amend section 7, I do not think overall that this bill is a sensible proposal.

Three sets of reasons have been advanced for amending section 7 at this time, and I think each of them is unpersuasive.

The first argument is that we need to amend section 7 to be easier on mergers so that firms can achieve efficiencies and compete more effectively in international trade. I start by pointing out that there is no evidence whatsoever supporting the view that the reason American firms occasionally do not do well in international trade is because they are not large enough. Would anybody seriously suggest that the reason Detroit is having problems in automobile manufacturing and sales is because General Motors and Ford are not large enough?

If there were some reason to think that our merger laws were hindering the achieving of efficiencies, and thus impairing our ability to compete in international trade, then the answer would be to introduce an efficiency defense into section 7, not to make our merger laws more lenient across the board in situations that have nothing to do with international trade.

Second, it has been argued that this statute will add certainty and predictability to the law. I noticed that Chairman Oliver talked about "greater precision." I would suggest that is the least valid of any of the reasons that have been offered.

The main thing this statute does is it changes the language—"substantially lessens competition and tend to create a monopoly"—which is the standard against which mergers have been measured, to language concerning "increases in the ability to exercise market power;" then market power is defined as the ability profitably to maintain price above competitive levels for a substantial period of time.

I suggest that it is simply common sense that a standard which talks about being "above competitive levels" does not add certainty and predictability. No one knows what a competitive level is in a market, and certainly no one knows to this date what constitutes the ability to exercise market power.

What this statute really does is to bury 70 years of precedent in merger enforcement in this country, the good as well as the bad, and throws businessmen into a new arena with new language that no one has ever interpreted before.

Finally, it is argued that the statute is necessary because if there is a change of administrations, it is important not to allow the next administration to go back to the restrictive practices of the past.

I think that U.S. merger laws were enforced in an overly restrictive way in the 1960's. I think some of those older antitrust cases are indefensible. But the enforcement agencies have not been bringing cases like that, and the courts have not been enforcing the law like that, in the last dozen years. It seems to me there is no reason to change the statute to take care of the remote possibility of a few foolish cases that may be brought somewhere down the line.

As to the statute itself, it is offered, as I said in my testimony, it is offered "in sheep's clothing." It is suggested that it is a modest change, and just codifies ideas that everybody agrees about. That is not true. There are many very controversial aspects of these guidelines, and it is not true that everybody agrees about them.

We talk about modern economic thinking as if everybody agrees to a certain school of economic thinking, but in fact economists are divided as to whether the so-called Chicago school approach to antitrust makes any sense at all.

I would add just a few other points. The idea of eliminating the "may be" and "tend to" language of the present statute is a mistake. Congress in 1950 realized that competition is a dynamic and not a static process. There may be mergers which in themselves are not anticompetitive but start a trend, trigger a trend, toward a cluster of mergers and therefore should be blocked in their incipiency.

I have already mentioned that this statute would wipe out all prior precedent by changing the key language. It also talks about increases in the ability to exercise market power. I would be troubled about a situation in which a firm already exercises maximum market power. It seems to me the language here would allow that firm to buy any firm and then defend by saying there is no increase in market power.

Just to be sure I am not entirely a naysayer here, I do want to mention one factor in the list of factors in the proposed bill that makes sense to me, and it is one, I guess, Mr. Campbell and I would disagree about. I think it is time to think seriously about a separate, clearly defined efficiency defense. I agree it would be difficult to implement, but there are situations in which two firms, both of which are inefficient in themselves, can combine and become more efficient together. And I see no reason why antitrust cannot take that into account.

Thank you.

[Prepared statement follows:]

TESTIMONY

of

ROBERT PITOFSKY
Professor of Law and Dean
Georgetown University Law Center

I would like to address two questions today: first, has the Administration put forward persuasive reasons why Section 7 should be amended at this time and, second, if so, do the proposed amendments make sense?

Let me state my conclusions briefly at the outset. I believe that the reasons put forward by the Administration for amending Section 7 are unpersuasive. I also believe that this proposed amendment is a major departure in antitrust thinking about mergers and joint ventures, but comes to this Committee dressed in sheep's clothing. These amendments are offered as little more than an effort to clarify existing law, introduce into the law a body of economic learning upon which virtually all sensible people agree, and codify existing merger enforcement practice. In fact, the proposed amendments would introduce extreme uncertainty into this area of law enforcement. Also, some of the economic theories upon which this amendment is based are controversial. Beyond both those points, the amendment language the Administration has proposed is almost certain to have the effect of not only cutting loose entirely from prior and present enforcement, but will move this country to a position where only mergers among the very largest companies in the most concentrated industries could be challenged. It would ratify the present complete absence of government enforcement against conglomerate mergers. As to vertical and horizontal mergers, it would complicate and expand the government's burden of proof in merger enforcement to the point where it would be difficult for the government to win almost any case.

A. Reasons to Amend Section 7

The Administration has offered three reasons for proposing its "merger modernization" statute: (1) relaxation of merger enforcement is necessary to allow U.S. firms to grow bigger and more efficient and, thereby, to compete effectively in international markets; (2) the proposed modification will increase certainty and predictability in enforcement; and (3) the new language of Section 7 will ensure that past overly restrictive approaches to merger enforcement will not be reintroduced, and will codify a more sophisticated mode of economic analysis.

1. Competition in International Markets.

I agree that all Americans have a stake in American companies thriving in international trade, and that there have been times when American firms have been bested in competition with foreign firms in domestic and foreign markets. But it simply does not follow from this that major overhaul of Section 7 is called for.

As currently enforced, Section 7 permits mergers and joint ventures between fairly sizable companies so that many efficiencies that might be achieved through consolidation are already available. There is simply no support for the position that there are vast numbers of other mergers and joint ventures, blocked by Section 7 as currently worded, that might occur if the statutory standard were relaxed. Indeed, this Committee heard testimony from Professor F. M. Scherer a month ago citing careful and thorough studies that cast doubt on the Administration's fundamental assumption that mergers on average are efficiency increasing. Even if there were some efficiency increasing mergers blocked by current enforcement, the remedy would be to introduce an efficiency defense into merger enforcement rather than to loosen restrictions on all mergers -- whether or not they produce efficiencies and whether or not they have any impact on international trade.

2. Certainty and Predictability

There is a value in certainty and predictability in antitrust enforcement, and the Administration deserves some credit, in promulgating its 1982 and 1984 guidelines, for being explicit about government enforcement intentions. On the other hand, there is no reason to believe that the Administration's proposed bill will add clarity to the law.

S.2160 cuts loose from 70 years of antitrust precedent. To now, the standard of legality has involved the question whether the probable result of a consolidation would be "substantially to lessen competition or tend to create a monopoly." In its place, the bill proposes to declare an acquisition unlawful

> "where there is a significant probability that such acquisition will substantially increase the ability to exercise market power."

It is inconceivable that this new bill would add clarity and predictability to the law. To be sure, Section 7 enforcement today subjects businessmen to many uncertainties, but that is unavoidable unless we adopt simplistic rules declaring mergers and joint venture legal or illegal on the basis of generalized considerations. Once a fact-oriented effort to sort out the procompetitive from the anticompetitive begins, uncertainty will attach to any transaction anywhere near the line. But that problem is only worsened by eliminating the previous statutory standard, and as a result over 70 years of precedent in interpreting that standard, and substituting the entirely novel and exceptionally vague question whether the consolidation allows the combined firm to "exercise market power."

The result will be that an accumulated body of expertise (including much recent new thinking about mergers) will be dislodged and, for a considerable time, much uncertainty introduced.

3. Ensure that Previous Overly Restrictive Approaches Do Not Reappear

Merger enforcement in the 1960s probably was unduly restrictive. The government in those years challenged mergers among relatively small firms in unconcentrated markets and was regularly substained in the Supreme Court. For example, in United States v. Vons Grocery Co., 384 U.S. 270 (1966), a merger in a deconcentrated market involving two companies with combined market shares of 7.5% was struck down; in Brown Shoe Co. v. United States, 370 U.S. 294 (1962), a vertical combination between a shoe manufacturer and a retail shoe chain, involving only about 2% or 3% of shoe outlets in the United States, was successfully challenged; and in FTC v. Proctor & Gamble Co., 386 U.S. 568 (1967), a conglomerate merger was struck down at least in part for the misguided reason that it generated substantial efficiencies.

But the government hasn't been bringing cases like that for at least a dozen years and most courts would reject those theories if they were reinstituted. There are scores of cases now in the Supreme Court and the lower courts that take a much more restrained view with respect to merger enforcement; see, e.g., U.S. v. General Dynamics Corp., 415 U.S. 426 (1974); United States v. Marine Bancorporation, 418 U.S. 602 (1974); Fruehauf Corp. v. FTC, 603 F.2d 345 (2nd Cir. 1979); BOC International Limited v. FTC, 557 F.2d 24 (2nd Cir. 1977).

This Administration has brought so few merger cases in the last five years that it is hard to tell exactly where the courts will draw the line with respect to legality. Some may feel as I do that the pendulum has swung too far in the direction of lenient merger enforcement, but hardly anybody expects that a change of Administrations would lead to a reinstitution of the discredited approaches to merger enforcement of the 1960s.

B. Analysis of Proposed Bill

If there were any reason to reconsider the language of Section 7 -- which there is not -- the Administration's proposal seems wide of the mark in many respects.

1. Standard of Legality

At present, Section 7 is violated where the result of a merger or joint venture may be to "substantially lessen competition or tend to create a monopoly." S.2160 would provide that a consolidation is illegal only where there is "a significant probability that such acquisition will substantially increase the ability to exercise market power."

If the Administration's purpose really is to codify current merger enforcement, this amendment is an odd way to reach that result. It not only would prevent the recurrence of extreme cases like Vons and Brown Shoe, but essentially would bury for purposes of precedent all prior Section 7 judicial decisions. By focusing on *increases* in the ability to exercise market power, it would make it impossible to challenge mergers in those industries where concentration is so great and barriers to entry so high that maximum market power is already being exercised. Finally, by eliminating the "may be" and "tend to" language of the present statute, it would make it impossible for the government to challenge a merger successfully that does not itself inordinately add to concentration, but that may trigger a consolidation process that is anticompetitive. This notion of stopping merger trends in their incipiency was a central feature of Section 7 reform in 1950, and has not been explicitly rejected in current enforcement. Of course, mergers should not be challenged if there is some remote possibility of future anticompetitive effects -- and perhaps there was some excessively restrictive merger enforcement of that sort in the 1960s -- but it is hardly necessary to change the standard of legality in the present statute in order to deal with that situation. Indeed, it is not necessary to do anything since the courts for 15 years have emphasized that they will not strike down mergers under Section 7 on the basis of mere speculation about anticompetitive effects.

There are two other important effects of this statutory change, not mentioned in the Administration's explication of its bill, that could result and would be unwise:

(a) Political Values. If the phrase "exercise of market power" is substituted for "lessening of competition," antitrust conversatives are likely to argue that Congress' intent now is to interpret the antitrust laws solely according to narrow economic standards. The Administration's exclusive emphasis in its analysis of the bill and in the 1982 Guidelines on economic factors is evidence of that intention. But Congress in 1890, 1914 and 1950 -- when the major antitrust laws were enacted or revised -- had in mind that antitrust would serve certain "political" (in the broad sense) as well as economic values. Specifically, Congress was concerned that an excessive concentration of economic power would lead to anti-democratic political pressures, and that anticompetitive practices would undermine individual and business freedom by narrowing the range within which private discretion could be exercised. Legislators also recognized that if antitrust were interpreted solely with economics in mind, the result might be an economy so dominated by a few corporate giants that it would be impossible for the state not to play a more intrusive role in economic affairs.*/

Most people agree that antitrust enforcement should reflect primarily economic concerns. Nevertheless, the elimination of a political dimension through exclusive reliance on economics (and a rather narrow and special "school" of economics at that), which is the stated goal of those currently enforcing the antitrust laws, misconceives the central role of antitrust in contributing to the American system of checks and balances.

(b) Conglomerate Mergers and Joint Ventures. If conglomerate mergers and joint ventures are challenged at all under the antitrust laws, it is on a theory that the arrangement tends to lessen potential competition. The challenge is based on the theory that, but for the consolidation, existing non-competitive markets would have become more competitive.

The new test, focusing on increases in the ability to exercise market power, will make it impossible to successfully challenge on a potential competition theory. This issue involves the difference between "never" and "hardly ever." There probably are relatively few conglomerate mergers and joint ventures that seriously threaten competitive values. But S.2160 says no merger or joint venture could ever be illegal on a potential competition theory -- a position directly contrary to much Supreme Court and lower court law.

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*/ See, Pitofsky, The Political Content of Antitrust, 127 U of Pa L. Rev. 1051 (1979).

2. Factor List

The second major change the Administration's bill would introduce requires courts to reconsider "all economic factors relevant to the effect of the acquisition . . .". The bill cites six specified factors and a catch-all category that must be taken into account. The factors cited and the "all factors" approach are proffered as a kind of "state-of-the-art" analysis with which most people agree.

In reality, most courts already take into account most of the factors cited by the Administration in its bill. But the particular interpretation of these factors, reflected in the Administration's 1982 and 1984 Guidelines and the Administration's analysis accompanying its proposed bill, is controversial. Several of these factors have been interpreted in such a way as to make merger enforcement extremely difficult, even among sizable firms in concentrated markets, and others in a way more likely to impede rather than assist intelligent merger analysis.

(a) Entry Considerations. Courts would be required to take into account ease or difficulty of entry by foreign or domestic firms and the ability of smaller firms in the market to increase production in response to an attempt to exercise market power.

Merger enforcement has profited in recent years from increased emphasis on conditions of entry and possibilities of expansion by fringe firms. Thus, if a particular merger significantly increases concentration, but that concentration is dissipated as soon as the firms in the market try to raise price, then the merger really is no threat to competition.

The problem is the Administration has emphasized future entry and expansion possibilities at the expense of virtually all other factors. Thus, the Department of Justice Guidelines treat as crucial the question of what would happen if prices in a particular market increased 5%; if it promptly attracted new competition from abroad, expansion of existing U.S. fringe firms, or completely new entry, the merger has been regarded as no significant threat to competition.

It is obvious from the Administration's analysis accompanying the bill that the new language about entry is intended to trigger this approach. But an undue emphasis on the question of what would happen if prices in a market increased can turn merger enforcement into a world of unlimited speculation. Shrewd lawyers and economists can be relied on to assert, no matter what product or what market, that an increase in price would result in a flood of new competition from various foreign and domestic sources. Prior law enforcement tended to emphasize past competitive responses, and would more likely credit the significance of various sources of substitute competition if there were some record that substitutions had previously occurred. This amendment could be viewed as endorsing current, extremely lenient enforcement policies on the entry question.

(b) Nature of the Product and Terms of Sale. The bill's language apparently is intended to reflect the Department of Justice Guideline notion that where, all other things being equal, products are not homogeneous or there is little detailed information about the products in the marketplace, collaboration among competitors is less likely to occur. Hence, mergers occuring in those circumstances should not be challenged.

The factors would appear to be of marginal significance. If concentration increases substantially, cartels become more likely regardless of the nature of the product or the amount of information in the marketplace. Issues like product homogeniety and product information are extremely complicated, and more likely to delay than enhance effective enforcement.

(c) Conduct of Firms in the Market. Another required factor turns upon whether the firms in the market have previously been engaged in express or explicit collusion, or had engaged in certain types of practices (like mandatory delivered pricing) that facilitates collusion.

The assumption here seems to be that if a firm once engaged in collusion or facilitating practices, it is more likely to do so again and, if it has a clean record in the past, collusion predictably is less likely. Neither of these circumstantial factors would appear to be very persuasive. The roster of people in charge of most corporations changes in relatively short periods of time. Thus, the fact that a corporation may have engaged in price fixing 20 years ago is little indication that the current management would take the same approach, and, by the same token, the fact that it had a clean cord 20 years ago says little about the intentions of present management. Once again we have a factor singled out for special emphasis that is more likely to complicate and delay merger enforcement than to render useful assistance.

(d) Efficiencies. The most interesting required factor would direct courts to take into account "efficiencies deriving from the acquisition."

The role of efficiencies in merger enforcement has had a checkered history. Efficiencies were barely mentioned in the legislative history relating to the amendment of Section 7 in 1950. There was a suggestion that the statute was not designed to prevent two small companies from combining in order to compete more effectively with larger rivals, and that probably was a round-about way of saying that efficiencies might be taken into account. Unfortunately, in two important early Supreme Court cases, efficiencies appear to have been counted against the merger*/ -- an interpretation of Section 7 that was unwise and virtually indefensible.

I agree that there should be an explicit efficiency defense to Section 7 enforcement, and suspect that an amendment tailored to that particular issue would have a good deal of support. The kind of efficiencies that would justify a merger or joint venture should be defined and the burden of proof placed squarely on the party asserting their existence. This is an area where the courts, perhaps constrained by clear Supreme Court precedent, might be reluctant without a legislative directive to modify their present approach. But this specific change is hardly reason to dismantle Section 7 enforcement to the extent contemplated by the Administration's bill.

(e) Catch-All Provision. The list of factors in the Administration's bill concludes with "any other evidence indicating whether the acquisition will or will not substantially increase the ability . . . to exercise market power." I assume the Administration's pur-

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*/ See, *e.g.*, *United States* v. *Brown Shoe Co.*, 370 U.S. 294 (1962); *FTC* v. *Proctor & Gamble Co.*, 386 U.S. 568 (1967).

pose here is to ensure that mergers are not prevented or cleared without a full exploration of all market factors.

The problem with this laudable concern relates to practical limits of the litigation process. As it is, antitrust enforcement often founders because investigations and trials go on so long and are so costly. Some sorts of presumptions arising from the size of the merging firms and levels of concentration in the market must be adopted. While short-cut approaches are dangerous, and there have been instances in which superficial analysis of mergers probably led to wrong results, this extreme, opposite approach, calling for the introduction of all relevant evidence, is a mistake.

The CHAIRMAN. Thank you very much, Dean Pitofsky.

Next is Mr. James P. Melican. Mr. Melican, we will be pleased to hear from you.

STATEMENT OF JAMES P. MELICAN

Mr. MELICAN. Thank you, Senator. I, too, will keep it brief.

Let me begin by saying I am very pleased to have the opportunity to present my views today in support of the adoption of S. 2160, the Merger Modernization Act of 1986.

The CHAIRMAN. Excuse me just a minute. I am going to have to go and open the Senate. I am going to ask the able and distinguished Senator from Alabama if he will preside. Oh, the Senator from Kentucky, I did not see you come in.

Senator MCCONNELL. Mr. Chairman, I am only going to be here briefly.

Senator HEFLIN. I will, likewise, be here only briefly. I thought the Republicans would feel some responsibility.

Senator MCCONNELL. In your able hands, Senator Heflin. Mr. Chairman, are you going over to open the Senate?

The CHAIRMAN. Do you want to preside or not? I have to go and open the Senate.

Senator MCCONNELL. I will wait until you get back.

The CHAIRMAN. Thank you.

Mr. MELICAN. I have read the statements of the witnesses who appeared on April 9 and May 12, and if I may say so, both the substantive and the intellectual content of the presentations made on those days on both sides of the issue was of such high caliber that I asked myself if I really had anything to add to these hearings.

I concluded that I could perhaps bring one perspective that you have not yet heard; that is, that of the corporate general counsel who is not nearly as much of an antitrust expert as many of your other witnesses, including my two predecessors here today, but who does on a frequent basis sit in on internal management meetings and sometimes board of directors meetings at which acquisitions or mergers are being discussed.

From that perspective the first point I would make is that even if some antitrust specialists had become persuaded that most American businesses are practically waiting in line for their chance to affect the horizontal merger and that only the antitrust laws are standing in their way, I think that is a somewhat parochial viewpoint.

In my experience many considerations other than antitrust get addressed first, including such factors as how will the board react, what will the stock analysts say, is there a good fit of the corporate cultures, what will the acquisition bring to us, and finally, will our employees see this as an opportunity to further advance their careers or as a demotivating factor if not downright job threatening.

The point I am making is that passage of this legislation will not, as some have anguished, open the floodgates to an irresistible tidal wave of mergers. Merger discussions, particularly in their early stages, are usually conducted by operating officers or managers who have spent years developing a business, not by detached professional economists with no personal interest in the outcome.

In short, human nature provides certain disincentives to mergers, and these proposed amendments are not going to change human nature.

The second general point I want to mention, again from my perspective as a corporate general counsel, is that business executives do not feel that the merger rules have been relaxed to merely the degree to which some witnesses at this hearing have claimed they have been. Most corporate executives from the start of their business careers have been raised on the notion that horizontal mergers between substantial competitors are probably illegal unless there is virtually no overlap in products or markets.

I realize that many of the antitrust experts who have testified before this committee would probably ridicule that notion as outdated, if not hopelessly obsolete. However, the fact remains that most business managers have no particular knowledge of merger law, and they are in many instances being advised by staff attorneys who are not themselves antitrust specialists.

Very few corporate executives want to go before their board, persuade them, and perhaps some large shareholders as well, of the merits of a merger or acquisition, and then have it challenged by the antitrust authorities.

In short, corporate executives continue to believe that the law in this area is very unsettled and uncertain, and they would rather err on the side of conservatism than end up looking rash or ill advised.

Again, I know that some of your prior witnesses whose intellect and knowledge I respect may find that difficult to believe, but I have spent more than 20 years counseling corporate officers and managers on an everyday basis and I am convinced that their perception is as I have described it.

I will end my prepared statement with that.

[Prepared statement follows:]

PREPARED REMARKS
OF
JAMES P. MELICAN
RESPECTING S.2160
THE
"MERGER MODERNIZATION ACT OF 1986"

Mr. Chairman and Members of the Committee:

I am James P. Melican, Vice President and General Counsel of International Paper Company. Previously, I was Vice President and General Counsel of Toyota (U.S.) and, before that, Assistant General Counsel of General Motors. I am a member of the Council of the ABA Antitrust Section, whose chairman, James Halverson, testified before this Committee last week. I am also a member of the Association of General Counsel and of the ABA Committee on Corporate Law Departments, but I am not appearing on behalf of either of those groups this morning. I am pleased to have this opportunity to present my views in support of the adoption of S.2160, the "Merger Modernization Act of 1986."

I would like to make two general points, and then three specific points regarding the proposed Section 7 amendments.

I.

I have read the statements of the witnesses who appeared on April 9th and May 12th and, if I may say so, the substantive and intellectual content of the presentations made, on both sides of the issue, was of such high caliber that I asked myself if I really had anything to add to these hearings. I concluded that I could perhaps bring one perspective that you have not yet heard; i.e., that of the corporate general counsel who is not nearly as much of an antitrust expert as many of your other witnesses, but who does, on a frequent basis, sit in on internal management meetings, and sometimes board of directors meetings, at which acquisitions or mergers are being discussed.

From that perspective, the first point I would make is that, even if some antitrust specialists have become persuaded that most American businesses are practically waiting in line for the chance to effect a horizontal merger, and that only the antitrust laws are standing in their way, I think that is a somewhat parochial viewpoint. In my experience, many considerations other than antitrust get addressed first, including such factors as:

-- how will the Board react,
-- what will the stock analysts say,
-- is there a good "fit" of the corporate cultures,
-- what will the acquisition bring to us, and
-- will our employees see this as an opportunity to further advance their careers, or as a demotivating factor, if not downright job threatening.

The point I am making is that passage of this legislation will not, as some have anguished, open the flood gates to an irresistible tidal wave of mergers. Merger discussions, particularly in the early stages, are usually conducted by operating officers or managers who have spent years developing a business, not by detached consulting economists with no personal interest in the outcome. In short, human nature provides certain disincentives to mergers, and these proposed amendments won't change human nature.

The second general point I want to mention, again from my perspective as a corporate general counsel, is that business executives don't feel that the merger rules have been relaxed to nearly the degree to which some witnesses at this hearing have claimed they have been. Most corporate executives, from the start of their business careers, have been raised on the notion that horizontal mergers between substantial competitors are probably illegal unless there is virtually no overlap in products or markets. I realize that many of the antitrust experts who have testified before this committee would probably ridicule that notion as outdated, if not hopelessly obsolete. However, the fact remains that most business managers have no particular knowledge of merger law and they are, in many instances, being advised by staff lawyers who are not themselves antitrust specialists. Very few corporate executives want to go before their Board, persuade them -- and perhaps some large shareholders as well -- of the merits of a merger or acquisition, and then have it challenged by the antitrust authorities. In short, corporate executives continue to believe that the law in this area is very unsettled and uncertain, and they would rather err on the side of conservatism than end up looking rash or ill-advised. Again, I know that several of your prior witnesses -- whose intellect and knowledge I respect -- may find that hard to believe, but I have spent more than twenty years counseling corporate officers and managers on an everyday basis and I am convinced that their perception is as I have described it.

II.

I would now like to briefly make three specific points regarding S.2160.

A.

During the more than twenty years in which I have acted as an inside legal advisor to three substantial U.S. corporations, I have not infrequently been asked to render advice to management concerning the legality of contemplated mergers or acquisitions under the antitrust laws. In so doing, I, of course, as any lawyer, have principally based my advice on past court decisions interpreting the very broad language of Section 7 of the Clayton Act.

As the committee well knows, there presently exists a broad spectrum of antitrust decisions which embrace a wide range of concepts to either uphold or reject, as the case may be, any particular merger. Included, for example, are such concepts as: (i) potential competition (conceived or actual), (ii) reciprocity effect, (iii) vertical foreclosure, and (iv) homogeneous versus heterogeneous product, to name but a few. In any given instance, it has been impossible to predict which of these concepts a court would choose to focus on. This has been a major problem for practitioners.

I do not mean to denigrate the usefulness of the Merger Guidelines. They have been extremely helpful to lawyers such as myself, but they do not, of course, have the effect of law. Accordingly, in nearly all situations where any degree of market concentration has been involved, I have had to render a qualified opinion to management, at least to the extent of cautioning about private rights of action. The proposed legislation, by spelling out the market power test and then defining it, would in my judgment go a long way towards eliminating the need for qualified opinions.

Furthermore, amending present law to more precisely specify the economic factors involved in determining the effect of the proposed acquisition -- while of course not insuring exact predictability in every case -- will also serve to greatly increase the confidence and certainty of advice given. This will, in my view, increase the ability of businessmen to make rational and predictable merger decisions, to the ultimate benefit of their companies, employees and stock owners.

B.

While I am not an economist, it seems clear that substantial strides have been made over the last decade in the ability of economists to evaluate both the competitive and anti-competitive effects of mergers. These analyses are in fact now commonly used by both businessmen and lawyers in evaluating the pros and cons of a proposed merger. They include, for example, administrative efficiencies, economies of scale, possible up-grading of products, greater research efforts, logistics improvements, and a host of other factors beneficial to the respective companies involved and, presumably, the overall U.S. economy.

At the same time, economists can now, with some degree of confidence, predict the anti-competitive consequences of a merger -- the ability to enhance the possibility for collusion or the abuse of market power. Under present case law, these anti-competitive factors may or may not be deemed dispositive -- depending on the precedent a particular judge decides to follow.

In my view, it is imperative that the present wording of Section 7 be modified to reflect modern economic analysis. As we all know, this is a time of unprecedented change for essentially all American businesses -- from the largest to the smallest. Many past assumptions about efficiency and productivity have (and must) be revised, if not discarded entirely. If beneficial mergers are prohibited, or perhaps worse, are not even considered at all, we will all be the worse for it.

If I might be permitted a personal reference, my own company, International Paper Company, was formed early in this century by the merger of a number of paper companies located in the Northeast United States. It has grown over the years to become a leading international competitor in the forest products industry, employing over 30,000 people.

nearly all of them in the United States. We are doing our best to see that it stays competitive on a worldwide basis, because in fact many of our major competitors are non-U.S. companies. One can only speculate as to whether, if a lawyer had been asked twenty years ago to counsel those initial Northeast paper companies, there even would have been an International Paper Company.

C.

Finally, in my view, S.2160 has ample safe-guards to enable a court to prohibit those mergers which, from an economic viewpoint, have a real likelihood of causing injury to American consumers -- through undue enhancement of the ability to fix prices or unwarranted market power -- while at the same time permitting those mergers which will not have such detrimental effects. As the Committee knows, the proposed legislation will mandate that a court examine all relevant economic factors -- on a worldwide basis if that is appropriate -- to determine if the merger will have detrimental economic consequences. Some witnesses before this Committee have complained that, while the Celler-Kefauver Act compelled the court to resolve the benefit of the doubt against concentration-increasing mergers, S.2160 would, by making it evident that concentration data is only a starting point, shift a greater burden of proof to the plaintiffs. If that is the case, and the effect of this legislation would be to require the courts to address any factors which modern economic analysis indicates are relevant in evaluating the effect of mergers, then I am all for it.

Thank you for your time. I will be happy to attempt to answer any questions the Committee may have.

Senator McCONNELL [presiding]. Thank you.
Professor Roth.

STATEMENT OF TIMOTHY P. ROTH

Mr. ROTH. Thank you, Mr. Chairman. I will distill my remarks as best I can.

Let me use as my point of departure the idea that I have testified in a number of antitrust cases, and I can tell you with some precision that there is a lot of uncertainty out there in the real world about what the court and, for that matter, what anyone else means by concentration, market power and efficiencies. So I think that, arguably the decisive reason to support S. 2160 is that it would provide merger evaluation standards which are straightforward—I think that is critical—intelligible and, relatedly, reflect what I characterize as the new economic learning and, most important, that would take account of the world as it is today rather than as it was back in 1950.

I will not comment about the world as it is today. I think we have talked that to death. I would like to say a couple of words about the so-called new economic learning.

I would, as an economist, make the case that contestable market theory has effectively swept the field, and it has one very simple idea at its core; that is, that if firms are able, incumbent firms are able to expand output and/or firms are able to enter an industry, then incumbent firms effectively have no market power. So we have got to take account of entry, and S. 2160 is very explicit about that.

The second thing I would say is that the so-called Williamsonian Tradeoff, which is an idea that has been around since 1968, is also a part of the new economic learning, and it recognizes that, whereas some mergers may result in increased market power, those same mergers may result in efficiencies, and that tradeoff suggests that under certain circumstances a firm with more market power—which at the same time experiences reductions in unit cost—would have an incentive to both lower price and increase output. In that particular case there would be agreement, at least among economists, that consumers would benefit because of the increased market concentration.

S. 2160 would take account not only of the role of entry but of international trade in particular and, relatedly, this idea of efficiencies. And on the matter of efficiencies, I would like to make a related point that I think is essential; that is, it is my view that if it can be shown that merged firms have no market power—that is, they are not able to raise price or that there is no significant probability that they can raise price—an efficiency defense is redundant. It should not be the burden of the court, the Federal Trade Commission, the Antitrust Division, the Justice Department or, for that matter, of the firms seeking to merge to demonstrate that efficiencies will occur.

The decisive point is that if they have no market power, whether or not efficiencies occur is irrelevant. The point is that if firms have no market power in the face of increasingly intense global competition, they have every incentive to lower unit costs on their own. If they do not, they will not survive. That is a different problem. It is, in any case, not the problem of the FTC, the courts, or the Antitrust Division.

Having said all that, I would emphasize that I support S. 2160 because I think it takes explicit account of those crucial points.

Thank you.

[Prepared statement follows:]

TESTIMONY OF TIMOTHY P. ROTH

Mr. Chairman and members of the Committee:

It is a pleasure to be here this morning to share my views on S. 2160, the Merger Modernization Act of 1986.

The intent of U.S. antitrust laws is unassailable. All of us want to foster competition and to maximize consumer well-being. But the antitrust laws are also a source of confusion.

As an expert witness in antitrust litigation -- both for the defense and for plaintiffs -- I have discovered that some producers are reluctant to meet competitor prices for fear of the *appearance* of price fixing. I have also heard sworn testimony revealing a reluctance to lower prices for fear of being charged with predation. As for mergers, potential merger partners remain confused about the standards to be applied in evaluating market concentration, market power, and efficiencies. This, in spite of the 1984 *Merger Guidelines* which were intended to "make antitrust enforcement more effective by providing more and clearer guidance in this difficult area."[1] The rule of thumb which American business seems frequently to follow is "Compete -- but not too successfully." This is hardly the decision rule we would want U.S. producers to follow. At least not in today's global markets.

S. 2160 provides us with an opportunity to codify merger evaluation standards which are straightforward and intelligible; standards which reflect the new learning in the economics of the firm and, most important, standards which recognize that the world is different today than it was in 1950.

I will not belabor the point that 1986 is different than 1950. I will simply state the obvious: U.S. producers ignore existing and potential foreign competition at their peril.

As for the new economic learning, economists now understand that big is not necessarily bad. This is especially true when producers are confronted by foreign and domestic competitors who can either enter the market, expand output, or both.

Contestable market theory[2] emphasizes the decisive role of *entry* and potential entry as a disciplinary factor: Firms have no market power when the appearance of extra-normal profits attracts competitors. The corollary is that increased market concentration -- through mergers or internal expansion -- is not necessarily harmful to consumers. And this is true whether or not internal expansion or mergers result in efficiencies.

When entry is difficult or, in the limit, impossible, increased concentration is still not necessarily bad. The so-called Williamsonian Tradeoff[3] recognizes that mergers which lead to increased market power should not necessarily be prohibited. Why? Because such mergers may result in efficiencies; in offsetting reductions in unit costs. With falling unit costs the response of profit maximizing firms would be to reduce price and increase output. In short, consumers could benefit because of increased market concentration. Again, big is not necessarily bad.

While the 1984 Merger Guidelines recognize this, they are not law. They are subject to relatively easy administrative change. When coupled with the baggage of decades of unsophisticated and sometimes inconsistent merger analysis the result is uncertainty. So long as firms are not sure about the standards to be applied, long-range planning is impaired. The problem is that the law covers mergers and acquisitions which "may" substantially lessen competition or may "tend to" create a monopoly. As an economist I do not know what that means. I suspect the lawyers do not either. And I know that CEOs do not know what it means.

The purpose of the Merger Modernization Act of 1986 is to eliminate the uncertainty, to take account of the world as it is in 1986, and to incorporate what economists have learned during the last 20 or so years about the economics of the firm.

The Act accomplishes this by making it clear that section 7 of the Clayton Act will prohibit mergers only when there is a "significant probability" that anticompetitive effects will follow. Of course one might reasonably ask how such a "significant probability" would be established. The Act provides an unambiguous answer: Section 7 is directed against mergers that threaten to increase consumer prices. Why? Because the exercise of market power is the decisive issue -- and market power is defined in the Act as "the ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time." This is what economists mean by market power, it is what CEOs mean by market power and, most important, it is what the consumer understands to be market power. The Act affirms that section 7 is intended to foster competition and protect consumers, not competitors.

And how is the question of "the ability to exercise market power" to be settled? By establishing an easily understood framework for analyzing the likely effects of mergers. The Act directs the courts -- and admonishes CEOs and other interested parties -- clearly to define both product and geographic markets.

The definition of product and geographic markets is not an arcane matter. Intuition, common sense and economic theory converge in asking the key question: Do the availability of close substitutes and the ability of other firms to expand output or to enter the market constrain price increases?

The Merger Modernization Act of 1986 would force a careful, systematic analysis of this question. The Act identifies six specific factors which should be considered in assessing the effects of mergers:

1. The number and size distribution of firms;
2. The "ease or difficulty of entry by foreign or domestic firms" into the market;
3. The "ability of smaller firms in the market to increase production in response to an attempt to exercise market power";
4. "the nature of the product and terms of sale";
5. The historical conduct of firms in the market;
6. Any "efficiencies deriving from the acquisition"; a factor to be considered only when the other factors considered suggest that a merger would result in a significant risk of exercise of market power.

Finally, the Act would require consideration of "any other evidence indicating whether the acquisition will or will not substantially increase the ability, unilaterally or collectively, to exercise market power."

This is consistent with economists' understanding of the crucial discipliary role of market entry. It is indisputable, for example, that import competition places a substantial limit on the exercise of market power.[4] To ignore the role of foreign competition in defining product and geographic markets would be to deny the facts. Equally important, when there is no evidence that a merger would result in a significant probability that market power could be exercised, an efficiency defense is redundant. Absent a significant probability that a merger will result in price increases there is no need to establish an affirmative case for the existence of efficiencies. Firms lacking market power have every incentive to reduce their unit costs. If they do not they will likely not survive in today's markets.[5] If they do not survive, that is a different problem -- it is not the problem of the courts, the Antitrust Division or the Federal Trade Commission. It should not be the business of government to predict which mergers will and which will not result in efficiencies. Nor should it be the responsibility of firms lacking market power to demonstrate that efficiencies will result.

No one gains -- least of all consumers -- by clinging to outmoded ideas about firm size. Economists from all over the ideological spectrum have been saying this for a long time. In 1982 Dominick Armentano noted that industry leaders have frequently been the objects of antitrust prosecution. Yet defendants had frequently gained their market shares by offering lower prices and better quality products.[6] In his 1980 book Lester Thurow describes the "futility and obsolescence of American antitrust laws."[7] In Thurow's view, the growth of international trade makes it impossible to determine whether an effective monopoly exists -- or could exist -- by looking only at domestic market shares.

Actual and potential market entry is the decisive competitive disciplinarian. The alternative to allowing pro-competitive mergers as a response to changing global market conditions is likely to be continuing pressure for trade restraints. While economists are -- or should be -- reticent about making predictions I am confident that trade restraints have one very predictable result: Price increases which place an unnecessary burden on the consumers whose well-being we are all interested in promoting.

\ Finally, I emphasize that passage of S. 2160 will not threaten consumers. The Hart-Scott-Rodino Merger Review Process will remain in place. And Sections 1 and 2 of the Sherman Act will continue to protect consumers and business if anticompetitive activities do occur. By amending Section 7 of the Clayton Act we will foster competition among firms, avoid protection of the inefficient, and stimulate economic growth.

FOOTNOTES

[1] Attorney General William French Smith, Press Release, June 14, 1984.

[2] William J. Baumol, "Contestable Markets: An Uprising in the Theory of Industry Structure." *American Economic Review*, Volume 72, March 1982. See also Michael Spence, "Contestable Markets and the Theory of Industry Structure: A Review Article." *Journal of Economic Literature*, Volume 21, September 1983.

[3] See, for example, Oliver E. Williamson, "Economies as an Antitrust Defense: The Welfare Tradeoffs". *American Economic Review*, Volume 58, March 1968; Oliver E. Williamson, "Economies as an Antitrust Defense Revisited." 125 *University of Pennsylvania Law Review*, April 1977. See also Robert H. Bork, *The Antitrust Paradox: A Policy at War with Itself* (Basic Books, 1978), esp. chapter 5.

[4] See, for example, Richard E. Caves, "International Trade and Industrial Organization. Problems, Solved and Unsolved." *European Economic Review*, Volume 28, August 1985; David Cox and Richard Harris, "Trade Liberalization and Industrial Organization: Some Estimates for Canada." *Journal of Political Economy*, Volume 93, February 1985; Manmohan S. Kumar, "International Trade and Industrial Concentration." *Oxford Economic Papers*, Volume 37, March 1985; Robert W. Crandall, "Economic Analysis of the LTV-Republic Merger," February 3, 1984.

[5] There is a body of evidence which suggests that the efficiency of large firms is the driving force behind observed profit-concentration relationships. See, for example, William F. Chappell and Rex L. Cottle, "Sources of Concentration-related Profits." *Southern Economic Journal*, Volume 51, April 1985. On the other hand, I should emphasize that there is little evidence that increases in firm size necessarily result in increased profits. See, for example, Louis Amato and Ronald P. Wilder, "The Effects of Firm Size on Profit Rates in U.S. Manufacturing." *Southern Economic Journal*, Volume 52, July 1985. See also Michael Smirlock, "Evidence on the (Non) Relationship between Concentration and Profitability in Banking." *Journal of Money, Credit and Banking*, Volume 17, February 1985. Finally, see Paul Pautler, "A Review of the Economic Basis for Broadbased Horizontal Merger Policy." *The Antitrust Bulletin*, Fall 1983. This stands to reason, of course, because while increases in firm size may result in lower unit costs this need not mean that profits will rise. Profits depend upon the interaction of costs and revenues, and the behavior of revenues is determined by consumer demand. Demand could fall at the same time as unit costs decline.

[6] Dominick T. Armentano, *Antitrust and Monopoly: Anatomy of a Policy Failure* (John Wiley and Sons, 1982).

[7] Lester C. Thurow, *The Zero-Sum Society* (Penguin Books, 1980).

Senator McConnell. Thank you. The Chairman has left behind a couple of questions which I would like to propound to the panel.

What are your views about whether social values, such as a preference for smaller companies or larger companies, larger numbers of companies, should be a part of merger analysis along with economic values?

Mr. Pitofsky. May I address that? I touched on it in my testimony.

There has been an increasing debate on the question of whether the antitrust laws should be enforced exclusively from an economic point of view and a rather narrow economic point of view.

I think there are what I would call "political", in the broadest sense, considerations that ought to be taken into account. However, I would not include among those considerations a preference for small business over large business. I do not think that makes very much sense.

I do think that Congress in 1890 and Congress in 1950 when they amended the merger provisions of the antitrust laws, had in mind that antitrust was broader than just economics, and addressed the question of whether or not undue concentration in the United States would lead to pressures on our democratic process. And I think there was also a concern that if companies grew too big, it would be inevitable that the Government would have to become more of a regulatory factor.

I do not think we are anywhere near that situation now in this country, but I do think, if you take the position of Mr. Roth, that efficiency is the only thing—or the primary thing—that counts, that nothing else matters, you may very well end up with an economy in which vast aggregations of market power occur. And in that situation it seems to me that there will be some threats to our political system, and that antitrust should be a part of the checks and balances that tries to prevent those threats.

Mr. Roth. Mr. Chairman, may I?

Senator McConnell. Yes.

Mr. Roth. If I may, first of all, I would like to make clear that I did not mean to suggest that efficiencies are the decisive considerations. In fact, in my view if it can be shown that entry conditions impede the acquisition of market power, then an efficiency defense is irrelevant; it is redundant. That is point number one.

The other thing I would like to say in response to the Chairman's question is that I would argue as an economist that if we begin thinking about antitrust policy explicitly as social policy, then we are only one remove away from having to take explicit account of what economists call social versus private costs. And I can tell you as an economist that we do not know how to measure those social costs. In fact, if just one person cares about one other person's consumption pattern, it is not possible, unambiguously, to measure social costs. So I would argue that that is a can of worms and we should avoid it as effectively as possible.

Senator McConnell. Am I right in suggesting that the factors enumerated in the administration's proposal are commonly considered in modern merger analysis but interpretations of those factors can be controversial?

Mr. **Melican**. I think, Senator, that clearly is the case, that all of those factors have been looked at, at least for the last several years, since the revised guidelines came out. None of them are new and none of them have appeared for the first time when this bill came out. I think they are being looked at, and the difficulty, as you suggest, is that they are looked at in the context of the existing case law, and because the case law does go back 20 years, it goes all over the map.

Anyone attempting to give advice is always put in the difficult position of attempting to figure out which way a particular court is likely to go in looking at past precedents and which of the factors it is going to emphasize more than others.

I think one of the advantages of the proposed bill is that it would basically require that all of the factors be looked at instead of running into a situation where one particular judge was enamored with one particular past precedent and emphasized that to the virtual exclusion of any other factors.

Mr. **Campbell**. Mr. McConnell, if I might comment on that.

Senator **McConnell**. Yes.

Mr. **Campbell**. Of the six factors, five are very easy for a judge to administer and will not lead to a great deal of controversy. I say that because they are particularized to the context of market power. The judge is not told, "go take a look at these six factors and do what you think is just". The judge is told "analyze whether these will lead to a significant probability of increase in market power".

So I think the controversy is quite limited. The one factor where I do not think it is limited is the one I have mentioned, efficiency.

Senator **McConnell**. Professor Campbell's written statement suggests that cost savings produced by mergers are difficult to measure and may be given the wrong treatment in the administration proposal. Would the rest of you like to comment on that?

Mr. **Roth**. Mr. Chairman, I would certainly agree that determining before the fact the behavior of unit or marginal cost or anything else as a result of a merger is a very difficult matter. There are a lot of simple and there are a lot of complex reasons for that, but I would emphasize, for example, that one of the things that we know happens when mergers occur is that the shadow prices that firms charge themselves for the use of inputs change. And it is very difficult to know exactly how they might change, and I submit that participants in a merger are likely not to know that before the fact. And, of course, how those shadow prices change affects the position of the unit cost curves and the marginal cost curves and so on and so forth.

So, yes, it is very difficult to do that. On the other hand, I would suggest that whereas looking at the efficiency question is problematic, looking at the market entry question is a good deal more straightforward. Looking at the problem of estimating concentration, market power, and potential for entry is something economists can do with nonproprietary information, I suggest; whereas, cost information is inevitably proprietary, and that may be difficult even for the Justice Department, for example, or the FTC to secure.

Senator **McConnell**. Either of you other two gentlemen?

Mr. **Pitofsky**. I would point out an irony in this debate. First of all, I agree with both the last speakers. Efficiencies are difficult to measure and perhaps somewhat more difficult than other factors to take into account. But look at where we are here. This bill is proposed, and it is obviously a bill that is going to loosen restrictions on mergers, on grounds that we need more efficiencies in order to compete more effectively in international trade. But then when someone says, well, all right, let us prove the efficiencies, the answer is, they are unprovable. It is an ironic situation.

One would have thought if there are real efficiencies in a market that companies would grow to achieve those efficiencies internally and not by a merger. The very fact that companies turn to merger suggests that the reason they are doing so may not always be a search for efficiency.

On the other hand, I am persuaded that there are some true efficiency situations, and what I think the bill does is to say, all right, we will give you an opportunity; prove the efficiencies Do not just talk about them. Let us see somebody prove it.

Senator **McConnell**. Mr. Melican, do you have any observations on this point?

Mr. **Melican**. Well, in a sense I agree that the efficiencies are difficult to prove in advance of the merger and, to a certain degree, in the abstract. However, I would submit that obviously from the standpoint of the antitrust authorities they are going to be aware of the fact that those questions will have been addressed in advance by both companies, and that both companies, for their own reasons, are going to have to have looked at the question of what efficiencies they think would be derived from a particular merger or acquisition.

I do not think it is a sufficient answer, as Dean Pitofsky suggests, just to say, gee, the company can grow. You know, I know in our case, for example, it costs more than $700 million to build the Greenfield paper mill, and there are not very many companies that can afford to do that any more.

So one of the things that you do look at is there a company out there that basically has a mill where we do not have one, that we might be able to acquire and pay a much discounted price from what it would cost us to go out and start all over again.

You know, that is one example, concrete example of where you look at who else is out there before you make that kind of an investment.

Senator **McConnell**. Gentlemen, thank you very much for coming. We appreciate it, and I believe that completes the agenda, does it not?

The hearing is adjourned

[Whereupon, at 11:07 a.m., the committee was adjourned, subject to the call of the Chair.]

APPENDIX

THE SECRETARY OF COMMERCE
Washington, D.C. 20230

June 18, 1986

Honorable Strom Thurmond
Chairman, Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

In the intervening weeks since the announcement of the proposed reforms to the antitrust laws, I have received many letters of support from Chief Executive Officers of major U.S. corporations. I thought you and the rest of the Committee would be interested in reviewing these letters, and I ask that they be a part of the hearing record.

I look forward to early consideration of S. 2160 and thank you for your fair and full consideration of all the antitrust legislation.

Sincerely,

Mac Baldrige
Secretary of Commerce

Enclosures

[illegible]

George J. Sella, Jr.
Chairman of the Board
President and CEO

'86 MAR 19 P2:54

[illegible]

March 14, 1986

Hon. Malcolm Baldrige
Secretary, Department of Commerce
14th Street and Constitution Avenue, NW
Washington, D.C. 20230

Dear Mr. Baldrige:

Thank you for your letter on the President's proposed legislative reform of the antitrust laws. I fully agree with you that these laws should reflect the realities of the global marketplace in which companies such as ours must compete and I support the President's initiatives in this area.

The proposed amendment to the merger statute offers an excellent opportunity to make clear, once and for all, that mergers and joint ventures should not be judged on outmoded court rulings of the 1950's and 1960's, but instead should be analyzed to take into account such real world factors as foreign competition. The proposed amendment to the Trade Act also correctly takes that factor into account by permitting distressed industries in the United States to compete more effectively with foreign competitors.

In addition, the Administration's proposed reform of the treble damage rule deserves support because it strikes a fair balance of strengthening the rule for clearly anticompetitive conduct and moderating it for conduct which in fact may be procompetitive. The proposed award of attorneys' fees to a company which successfully defends a frivolous lawsuit and the proposed right of claim reduction also are both fair and reasonable reforms.

Finally, both the amendment of the interlocking directorate statute and the clarification of the extent of U. S. antitrust jurisdiction are significant improvements in our antitrust laws. It is becoming increasingly difficult to find qualified directors to serve on the boards of major corporations, especially in view of their potential exposure to liability and the difficulty of obtaining director and officer insurance coverage. At the same time, when a competitive overlap is de minimis, companies are not "competitors" in any meaningful sense of that word. The proposed amendment reflects these present day business realities. The reform on U. S. antitrust jurisdiction, by clarifying the factors to consider before exercising jurisdiction, likewise recognizes the real world: in this case, the risk of interfering in foreign policy matters by an unwarranted extension of our antitrust laws abroad.

Sincerely,

G. J. Sella, Jr.

613219

'86 APR 28 P2:47

Richard de J. Osborne
Chairman and President

April 24, 1986

Hon. Malcolm Baldrige
Secretary of Commerce
Washington, D.C. 20230

Dear Mr. Secretary:

This is in response to your letter concerning President Reagan's proposed reform of the nation's antitrust laws and offering to discuss the proposals with us. We have reviewed the proposals in quite some detail, and we enthusiastically support this type of broad reform of our antitrust laws which in many cases do not reflect in their present form the realities of today's international economy. While in certain areas we would have preferred to see the President's proposals go further -- for example, to reduce the potentially devastating and inequitable effects of joint and several liability -- we feel that, on the whole, the President's package goes a long way towards allowing United States industry to compete on even terms in the international arena. For this reason we commend and support the President's efforts.

We do not think it necessary to take up your time to discuss the proposals in person, but appreciate your offer to do so.

Thank you for the materials. The briefing paper was most useful to our analysis of the legislation.

Sincerely yours,

Richard de J. Osborne

RdeJO/mgl

ASARCO Incorporated 180 Maiden Lane New York, N.Y. 10038 (212) 510-2008

611383

Bethlehem Steel Corporation

BETHLEHEM, PA 18016

DONALD H. TRAUTLEIN
CHAIRMAN

'86 MAR 10 P3:51

March 6, 1986

The Honorable Malcolm Baldrige
Secretary of Commerce
Department of Commerce
14th & Constitution Avenue, N.W.
Room 5854
Washington, DC 20230

Dear Secretary Mac Baldrige:

Thank you for sending me the President's antitrust reform proposals. We have been following this important initiative with great interest and enthusiasm. In particular, the proposed modification of Section 7 of the Clayton Act strikes me as a very constructive response to the realities of today's global competition.

Based on Peter Rodino's op ed response, it is clear that your initiative has triggered a timely and useful public policy debate. I assure you that we will continue to speak out in support of the Administration's antitrust initiative and to work for its advancement in Washington.

Sincerely,

Don Trautlein

CHAMPION

CABLE ADDRESS CHAMPION

Champion Spark Plug Company

P.O. BOX 910, TOLEDO, OHIO • U.S.A. 43661-0001
TELEPHONE AREA CODE 419 • 535-2567

6 [illegible] 0

...MERCE
...TARIAT
'86 APR 14 A11 :07

April 10, 1986

Mr. Malcolm Baldridge
Secretary of Commerce
Washington, D. C. 20230

Subject: Antitrust Reform Proposals

Dear Mr. Secretary:

This letter is written in support of the President's proposal to reform certain aspects of our antitrust laws.

Having experienced a lengthy and expensive FTC investigation, trial and appeals on a Section 7, Clayton proceeding, we feel that the proposed amendment will terminte such investigations at a much earlier stage. The phrases "significant probability" and "exercise market power" as defined will benefit all companies whose merger or acquisition does not have anticompetitive results.

With respect to the 5-year exemption to Section 7 of the Clayton Act, we are not convinced that this really addresses the issue. A comprehensive foreign trade policy would be a more appropriate response. Domestic companies injured by foreign competition should not be allowed to form cartels and the like. In our opinion, this provision would create more problems in assessing corporate conduct.

Finally, we support the reform proposals for detrebling damages except for price fixing, for empowering courts to dismiss private actions involving foreign entities and for the deminimus exception to Section 8 of the Clayton Act.

Very truly yours,

CHAMPION SPARK PLUG COMPANY

R. A. Stranahan, Jr.
Chairman and
Chief Executive Officer

RAS,JR.:ds

612466

COMBUSTION ENGINEERING

Charles E. Hugel
President
Chief Executive Officer

April 8, 1986

'86 APR 10 P2:04

The Honorable Malcolm Baldrige
Secretary of Commerce
Washington, D.C. 20230

Dear Secretary Baldrige:

Thank you for the letter which you, Attorney General Meese, and Secretary Baker recently sent me concerning the Administration's proposed antitrust reforms.

We support your efforts to update the federal antitrust laws, which are in need of amendment to reflect the new realities of America's economy, worldwide competition, and our nation's accumulated experience with respect to the vital areas of industrial organization and efficiency.

The law should provide the business community with clear, up-to-date direction in such important areas as mergers and other reasonable competitive business conduct. Aggressive competition is the hallmark of the American system, and managers should not operate in fear of punitive treble-damage actions in these areas.

Your legislative proposals are pro-competitive and pro-consumer, and their enactment should materially improve the economic viability of our country.

Sincerely,

Combustion Engineering, Inc.
900 Long Ridge Road
Post Office Box 9308
Stamford, Connecticut 06904
(203) 328-7700

612286

CONSOLIDATED PAPERS, INC.
CORPORATE OFFICES WISCONSIN RAPIDS, WISCONSIN 54494

'86 APR -7 P [illegible]

GEORGE W. MEAD
CHAIRMAN OF THE BOARD
(715) 4[illegible] 3395

April 3, 1986

Mr. Malcolm Baldrige
Secretary of Commerce
Washington, DC 20230

Subject: Your letter re antitrust reform.

Dear Mr. Baldrige:

You, Mr. Meese, and Mr. Baker mailed me on February 25 the Administration's proposal for reform of our nation's antitrust laws.

I have personally studied the proposed reforms carefully.

I do not feel competent to comment on most of them. There is one area, however, which I feel is terribly important and would like to endorse completely and enthusiastically.

This has to do with the proper allocation of treble damages between multiple defendants.

Our company, Consolidated Papers, has had antitrust problems of a minor nature twice in the past fifty years. In both cases, we felt that we were innocent and did in fact successfully defend ourselves even though all other participants took the route of "consent decrees."

In today's antitrust environment, the ability to conduct a successful defense of this kind becomes almost impossible due to the joint and several nature of the penalties and the likelihood that early settlements will not cover an appropriate share of them. I have seen this happen in several recent instances and feel that it is highly unfair to those companies which have conducted themselves properly, particularly in light of the fact that the plaintiff's lawyers are likely to include all possible "deep pocket" types of defendants, innocent or guilty.

April 3, 1986

Mr. Mac Baldrige
Page 2.

The appropriate reforms appear on pages 6 and 7 of Title IV-Claim Reduction, Section 401. I have xeroxed and marked the pertinent areas which I would encourage you to vigorously promote.

I am taking the liberty of sending my letter to the members of the Wisconsin congressional delegation to indicate my support.

Yours truly,

Geo. W. Mead

George W. Mead

CC: U.S. Senators: Robert W. Kasten, Jr.
William Proxmire

U.S. Representatives: Les Aspin
Steve Gunderson
Robert W. Kastenmeier
Gerald Kleczka
Jim Moody
David R. Obey
Thomas E. Petri
Toby Roth
F. James Sensenbrenner, Jr.

[illegible]2

COOPER INDUSTRIES

April 1, 1986

'86 APR -3 P3:28

The Honorable Secretary
 of Commerce Malcolm Baldridge
Room 5854
14th Street at Constitution
 Avenue Northwest
Washington, D.C. 20230

Dear Secretary Baldridge:

Thank you for sending to us a copy of the President's proposed legislative reforms to our nation's antitrust laws and the accompanying briefing paper. We appreciate the opportunity to discuss these proposals with you, and I would like to say generally before commenting on the specifics of the proposals that your efforts to bring the antitrust laws into harmony with modern economics are appreciated. We will do what we can to assist you in this effort.

First, with respect to the "Merger Modernization Act of 1986", we applaud your efforts to provide the courts with guidance and to move them a little closer to a "real world" analysis of mergers. We also appreciate the value of codifying this gain.

With regard to the proposed limited antitrust exemption for industries injured by imports, we are less sanguine, but nevertheless understanding of the problem being addressed.

As you have so correctly observed in your analysis of antitrust remedies, treble damages for violations of the antitrust acts have the tendency to restrict conduct or arrangements that contribute to efficiency and lower prices to consumers. We also recognize that price fixing and bid rigging are not to be condoned. You have chosen to allow a recovery of treble damages for injuries sustained by reason of the plaintiff "having been overcharged or underpaid". We have some concern that this new terminology may yet allow treble damage recoveries for efficient vertical distribution practices, having no horizontal aspects. We would prefer that the proposed "Antitrust Remedies Improvement Act of 1986" clearly except from trebling, all those damages sustained because of distributional practices. We are heartened to see you propose some balance to sections 4 and 16 of the Clayton Act by proposing the awarding of costs, including attorneys fees, to substantially prevailing defendants if the plaintiffs conduct has been "frivolous, unreasonable,

COOPER INDUSTRIES INC

First City Tower Suite 4000 PO Box 4446
Houston, Texas 77210
(713) 739-5400

without foundation or in bad faith", and we agree with your proposal that a plaintiff who settles with one or more defendants in an antitrust action should have his claim against the remaining defendants appropriately reduced.

We are glad to see an attempt to rationalize the effects of our antitrust laws with international notions of extraterritoriality. Perhaps the "Foreign Trade Antitrust Improvements Act of 1986" should apply to our export control laws as well.

Finally, with regard to the "Interlocking Directorate Act of 1986": the corporate community is in real need of a de minimis standard for defining competition between two different companies on whose boards a common director sits. We feel your proposals are well considered, and we endorse them.

Again, we are most appreciative of the efforts of this Administration to recognize some of the legal problems with which industry in this county is confronted and to address them with well reasoned legislation. We are prepared to lend our support to obtaining Congressional approval of the President's proposals for Antitrust reform.

Yours very truly,

Alan E. Riedel

Alan E. Riedel
Senior Vice President,
Administration

AER/sb

611051

Cummins Engine Company, Inc.

Box 3005
Columbus, Indiana 47202-3005 Telephone 812 377 3164

Henry B. Schacht Chairman of the Board
and Chief Executive Officer

'86 MAR 11 A9:56

DEPT. OF COMMERCE
OFFICE OF THE SECRETARY
EXECUTIVE SECRETARIAT

March 10

The Honorable Malcolm Baldrige
Secretary of Commerce
Room 5851
Herbert C. Hoover Building
14th Street and Constitution Avenue, N.W.
Washington, D.C. 20230

Dear Secretary Baldrige:

You asked for some comments on the impact of current antitrust law on the competitive position of U.S. firms.

An illustration of how these laws work to the detriment of U.S. firms can be found in the U.S. Class 8 (heavy duty) truck industry. This industry is Cummins Engine Company's largest single customer. For some period of time this industry has been comprised of 7 domestic firms: IHC (now Navistar), PACCAR, Mack, Freightliner, Ford, GMC and White. The industry is violently cyclical and is currently plagued by overcapacity.

In the last several years Freightliner has been bought by Daimler-Benz, White has been bought by Volvo, and Renault has acquired a controlling interest in Mack. The problem in this set of events is that under current antitrust law, there is significant uncertainty as to whether any of the domestic companies would have been permitted to buy the three companies bought by the Europeans. Since the Europeans were not currently selling in the U.S., they were allowed to buy the U.S. companies even though in a world environment, the three Europeans are much larger factors in heavy duty trucks than the remaining U.S. companies. Thus, the remaining U.S. companies are unable to achieve the economies of scale that the Europeans now have. In addition, the European companies now have acquired invaluable distribution systems through which they can put their European product in competition with the U.S. built product.

No one is saying that the European firms shouldn't have access to the market; the point is that because competition in heavy duty trucks occurs on a worldwide basis, the U.S. firms should not have been restricted by antitrust laws from the acquisitions and resultant efficiencies that the Europeans were allowed to achieve.

This situation not only puts the remaining U.S. truck firms in a weakened position, but works to the disadvantage of all the U.S. suppliers of this industry. European truck manufacturers use their own engines, transmissions, and axles almost exclusively and, to the extent that the remaining four U.S. truck firms are weakened, the U.S. supply base is also weakened.

One remedy would be to allow a world market test of competitiveness. The idea of the largest worldwide heavy-duty truck company being allowed to acquire a company that PACCAR and Navistar would not be allowed to acquire under U.S. antitrust laws doesn't make competitive sense and works against U.S. interests.

Obviously, this summary does not address all of the pertinent issues in detail. If a more detailed statement would be of use to you, I will provide one in a week or so.

Sincerely yours,

Henry B. Schacht

cst

Data General
4400 Computer Drive, Westboro, MA 01580
Telephone (617) 366-8911

April 30, 1986

G13424
'86 MAY -2

The Honorable Malcolm Baldridge
Secretary of Commerce
Washington, D.C. 20230

Dear Mr. Secretary:

Your letter to Mr. Edson de Castro dated February 25, 1986, which enclosed a copy of the Administration's Legislative Proposal for Antitrust Reform, was referred to me for review. We are pleased that you have given us the opportunity to comment on the Administration's recommendations to reform the nation's antitrust laws.

We have reviewed the Administration's proposals, and we are in full agreement with the reform to the treble damage litigation, the expanded exemptions for interlocking directorates and the antitrust jurisdiction in international commerce cases.

With respect to the proposed amendments to Section 7 of the Clayton Act and to Sections 201-203 of the Trade Act of 1974, we are in general agreement with the conceptual goals sought to be accomplished by these proposals.

We would additionally suggest that perhaps detailed views of the computer industry, including those of Data General, be solicited through the American Electronic Association, of which Data General is a member.

We thank you for this opportunity to present our views on this matter and to endorse the efforts of the Administration in modernizing the antitrust laws.

Respectfully submitted,

Jacob Frank
Vice President and General
Counsel

cc: Mr. Edson D. de Castro

JF/jnk

[illegible]

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March 31, 1986

Mr. Mac Baldirge
Secretary of Commerce
14th St. between Constitution Ave & E Street N.W.
Washington, D.C. 20230

Mr. Edwin Meese, III
Attorney General
c/o Department of Justice
Constitution Avenue & 10th Street N.W.
Washington, D.C. 20530

Mr. James A. Baker, II
Secretary of the Treasury
15th Street & Pennsylvania Avenue N.W.
Washington, D.C. 20220

'86 APR -3 P3:31

Gentlemen:

I have read the President's proposed legislative reforms and the accompanying briefing paper on the subject of the nation's antitrust laws, which you sent to my attention.

After reading both documents, I believe and support the efforts of the President and the recommendations of the staff. If business is to compete effectively worldwide in the environment that exists today, certainly changes must be made in laws that are no longer effective and tend to limit our nation's growth.

Again I do support you in this effort and urge you to continue your efforts.

Sincerely,

DIEBOLD, INCORPORATED

Robert W. Mahoney
President
Chief Executive Officer

RWM/vb

THE DOW CHEMICAL COMPANY

PAUL F. OREFFICE
PRESIDENT AND CHIEF EXECUTIVE

2030 DOW CENTER
MIDLAND, MICHIGAN 48640

612486

'86 APR 10 AM 11:44

[illegible]

April 7, 1986

Malcolm Baldridge
Secretary of Commerce
Department of Commerce
Washington, D.C. 20230

Dear Mac:

Thank you very much for sending me a copy of the President's proposals for antitrust reform. We applaud the proposals as excellent and much needed, and we will give them our enthusiastic support.

Sincerely,

PFO:p

DU PONT

E. I. DU PONT DE NEMOURS & COMPANY

WILMINGTON, DELAWARE 19898

CHAIRMAN OF THE BOARD

'86 MA

March 11, 1986

Honorable Malcolm Baldrige
Secretary of Commerce
14th St. between Constitution
Ave. and E Street, N.W.
Washington, D.C. 20230

Honorable Edwin Meese, III
Attorney General
Tenth Street and
Constitution Ave., N.W.
Washington, D.C. 20530

Honorable James A. Baker, III
Secretary of the Treasury
15th Street and
Pennsylvania Ave., N.W.
Washington, D.C. 20220

Gentlemen:

Thank you for your letter of February 25 requesting our views on the President's proposed reforms of the antitrust laws. Du Pont supports the general objectives of the President's legislative package. We agree that Section 7 of the Clayton Act should be amended, as outlined in your proposal, to reflect the philosophy of the 1984 Merger Guidelines, and we support revising antitrust remedies to limit treble damages and to reduce claims by the amount attributable to settling persons as provided in the draft legislation. We also believe that the proposal to revise the prohibition against interlocking directorates will increase the ability of companies such as Du Pont to obtain the services of well qualified outside directors.

When these legislative proposals are considered by the Congress, comments and alternative proposals will likely be offered by a number of organizations. As I indicated in my earlier letter, we will be working through the Business Roundtable and other organizations to develop and present industry comments.

We look forward to working with you on these important reforms.

Sincerely,

E. G. Jefferson

E. M. de Windt
Chairman of the Board
and Chief Executive Officer

Eaton Corporation
Eaton Center
Cleveland, Ohio 44114

March 24, 1986

The Honorable James A. Baker, III
Secretary of the Treasury
15th and Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Mr. Secretary:

This letter is in response to the February 25, 1986 letter from Secretary Baldrige, Attorney General Meese and yourself, concerning President Reagan's legislative proposals for reform of the antitrust laws.

I have received the President's proposals with a somewhat mixed reaction. Certainly, a de minimis standard for interlocking directorates, detrebling of some antitrust recovery and attorneys' fees for defendants in situations involving frivolous law suits are long overdue.

On the other hand, the changes proposed for the Clayton Act antimerger statute will, in my opinion, create market confusion rather than market efficiency and be disruptive rather than supportive to a strong U.S. manufacturing base.

It seems unrealistic to blame the U.S. antitrust laws for industry's perceived inability to compete effectively in the international arena. Failure of the Federal Government to get its financial house in order, waste of corporate assets through scorched-earth fending off of hostile takeovers and burgeoning debt resulting from ill-conceived mergers are more likely contributors to our country's struggles in the international marketplace.

I appreciate this opportunity to comment on the proposals.

Sincerely,

E.M. deWindt

E.M. de Windt

EMdeW:jag

cc: [redacted]
Honorable Edwin M. Meese, III

EMERSON ELECTRIC CO
8000 W. FLORISSANT
P. O. BOX 4100
ST. LOUIS, MO 63136

CHARLES F. KNIGHT
CHAIRMAN AND
CHIEF EXECUTIVE OFFICER

'86 APR -2 P2:21

March 31, 1986

Mr. Malcolm Baldrige
Secretary of Commerce
Department of Commerce
Washington, D.C. 20230

Dear Secretary Baldrige:

Thanks for your letter of February 25, 1986, by which you transmitted the President's legislative proposals for antitrust reform. We have carefully studied these proposals and support the entire reform package; we are particularly in favor of the Merger Modernization Act and the Interlocking Directorate Act.

We believe that the Justice Department's Merger Guidelines of 1982 and 1984 represented a giant step forward in the development of a meaningful analysis of the competitive effects of mergers and acquisitions. By incorporating the substance of these Guidelines in legislation, the Merger Modernization Act assures preservation of the advances made by the Guidelines notwithstanding a future change of administrative attitude.

The incorporation of a de minimis standard in the Interlocking Directorate Act is long overdue. As you well know, corporations are becoming increasingly diversified through acquisition and internal development. Such diversification is healthy and procompetitive. Unfortunately, diversification sometimes causes conflicts of a de minimis nature for board members who, under current law, are therefore forced to resign from the board of one of the companies. Although we agree that significant conflicts should not be legalized, there is no reason to condemn those arising from miniscule overlaps when they, in fact, pose no antitrust risk. Unless the Interlocking Directorate Act is enacted, the frequently insignificant conflicts arising from increased corporate diversification will force further unnecessary board resignations with a consequent loss to the economy and to the American public.

Thank you again for sharing this information with me. I strongly support your efforts.

Sincerely,

Charles F. Knight

[illegible]849

C. C. GARVIN, JR.
Chairman of the Board

'86 MAR 24 [illegible]

March 18, 1986

The Honorable Malcolm Baldrige
Secretary of Commerce
Washington, DC 20230

Dear Mac:

Thank you for your letter of February 25, 1986 addressing antitrust reform. We have been following closely and with considerable interest the review undertaken by the Cabinet-level working group. The recommendations growing out of this review suggest a number of constructive approaches toward reform of the nation's antitrust laws. Exxon is participating with the Business Roundtable and other business organizations in a careful analysis of the President's proposals and we hope to be in a position to discuss specific views through these organizations in the very near future.

Sincerely,

cc: The Honorable Edwin Meese III
The Honorable James A. Baker III

EXXON CORPORATION · 1251 AVENUE OF THE AMERICAS, NEW YORK, N.Y. 10020

Inland Steel Company
30 West Munroe Street
Chicago Illinois 60603

312 346 0300

Frank W. Luerssen
Chairman and Chief Executive Officer

612365

Inland Steel

'86 APR 8 P3:30

April 3, 1986

The Honorable Malcolm Baldrige
Secretary of Commerce
Department of Commerce
Washington, DC 20230

Dear Mr. Secretary:

Thank you for sending me copies of the President's proposals to modify the antitrust laws. I appreciate your invitation to comment on these proposals.

I enthusiastically support the proposals which would modernize the antitrust laws to enhance the competitiveness of U.S. companies in a worldwide market and which would discourage frivolous litigation. It is also desirable that Section 8 of the Clayton Act be modified to insure the availability of qualified directors to U.S. companies.

However, I am deeply concerned over one aspect of the Promoting Competition in Distressed Industries Act. If relief were provided under this Act, an industry would be unable to protect itself against unfair trade practices of foreign competitors for a period of ten years through recourse under the existing laws of the United States. This could easily lead to the total destruction of such an industry well before the ten year period had run.

I would be pleased to discuss any of these issues in greater detail with you or your staff.

Yours very truly,

FWL:jd

611238

Louisiana-Pacific Corporation

111 S.W. Fifth Avenue
Portland, Oregon 97204
503 221-0800

'86 MAR -6 A10:51

March 3, 1986

Honorable Malcolm Baldrige
The Scretary of Commerce
Washington, D. C. 20230

Dear Secretary Baldrige:

Louisiana-Pacific Corporation is very supportive of President Reagan's proposed amendments to the antitrust laws as digested in your letter of February 25.

It is encouraging [redacted] considers the [redacted] competition and [redacted]-market [redacted] contesting for [redacted] plant divestiture order [redacted] under the old [redacted].

Treble damages are a form of punitive damages that have been grossly misapplied in recent years. L-P welcomes any effort to limit such damages to the extreme situations, and to more reasonable amounts.

Sincerely,

H. A. Merlo
Chairman & President

MERCK & CO., INC.
P O BOX 2000
RAHWAY, NEW JERSEY 07065-0900

611681

P. ROY VAGELOS, M.D.
PRESIDENT AND CHIEF EXECUTIVE OFFICER

March 17, 1986

'86 MAR 20

The Honorable Malcolm Baldridge
Secretary of Commerce
Washington, DC 20230

Dear Mr. Baldridge,

We have reviewed carefully the materials you sent describing the President's proposed reform of the Federal antitrust laws. The direction taken appropriately reflects the current realities of international competition and we believe that enactment would be beneficial. We will be following the progres of the proposals with a great deal of interest.

Sincerely yours,

Roy Vagelos

PRV:RAK

General Offices 3M

3M Center
St. Paul, Minnesota 55101
612/733 1110

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3M -3 P3:30

March 31, 1986

The Honorable Malcolm Baldrige
Secretary of Commerce
Washington, D. C. 20230

The Honorable Edwin Meese III
Attorney General of the United States
Department of Justice
Washington, D. C. 20530

The Honorable James A. Baker III
Secretary of the Treasury
Washington, D. C. 20220

Gentlemen:

We have followed with great interest the development of the Administration's antitrust reform package. We are writing to express 3M's support for the efforts of the President and the Cabinet to stimulate Congress into a meaningful review of these pre-World War I statutes to determine the extent to which these laws have become outmoded and counterproductive.

We are ardent believers in the fundamental premise of the antitrust laws that competition in free markets is the best means of maintaining an efficient economy. Nevertheless, 3M's experiences over the past decade have convinced us that substantial modification is needed in certain key portions of the statutory framework.

We are particularly mindful of the abusive practices that have taken hold in private enforcement where too frequently individuals are free to threaten or file baseless antitrust suits in hope of extracting substantial nuisance settlements. The law currently allows such exploitative access to the courts to be essentially a no-risk proposition for plaintiffs a~~nd their~~ counsel. Your proposals to de-treble the damage remedy with respect to most business practices and to expose plaintiffs to liability for defendant's attorney's fees in frivolous suits is a fair and appropriate cure.

In addition, as we search periodically for qualified outside directors, 3M, because of its broad diversity, often encounters in otherwise outstanding candidates petty conflicts under the hopelessly obsolete standards of Section 8 of the Clayton Act. This portion of the antitrust laws should have been changed years ago, and we are optimistic that everyone in Congress will recognize this fact and respond favorably to this initiative for reform.

Finally, our experience at 3M in the area of mergers and acquisitions persuades us that the modernization of Section 7 initiated by the Department of Justice via the "Guidelines" process has been beneficial to American industry and consumers alike and that this Administration's method of assessing merger effects ought to have a more secure and permanent place in antitrust. Hence, a formal revision to the merger statute is clearly in order.

We urge that Congressional leaders in both parties put forth a substantial effort to assure that all your proposals receive careful consideration and that enactment of appropriate amendments in this session be given a high priority.

Sincerely yours,

Charlton Dietz

Allen F. Jacobson
Chairman of the Board

Charlton Dietz
Vice President
Legal Affairs

CD:nk

Mobil Corporation

150 EAST 42ND STREET
NEW YORK, NEW YORK 10017 5666

ALLEN E. MURRAY
CHAIRMAN OF THE BOARD
CHIEF EXECUTIVE OFFICER

March 14, 1986

The Honorable Malcolm Baldridge
The Honorable Edwin Meese III
The Honorable James A. Baker III
Washington, D.C. 20030

ANTITRUST REFORM

Gentlemen:

Thank you for sending Mobil the President's proposed antitrust reforms.

I applaud the efforts of your Cabinet-level working group to modernize the antitrust laws to reflect the domestic and international markets in which American firms compete today. In response to your invitation to discuss these proposals, I will detail Mobil's comments on each one.

Interlocking Directorate Act of 1986. This is a much needed and thoughtful reform of Section 8 of the Clayton Act. It is exceedingly difficult to attract competent and desirable board members today. The question of directors' liability and the difficulty of obtaining adequate insurance to protect directors and officers make many persons unwilling to serve. It is therefore particularly important that Section 8 of the Clayton Act only prevent a director from serving on more than one board when there would be a serious effect on competition. This amendment will increase the pool of eligible director candidates and help to alleviate the serious shortage which is manifesting itself in this area.

Antitrust Remedies Improvements Act of 1986. The claim reduction provision that you propose would certainly be preferable to the current system. However, like the rest of the business community, Mobil strongly supports Senator Thurmond's bill, S.1300, on individual treble damage responsibility. That bill, as you know, would eliminate joint and several liability thus making claim reduction unnecessary. Thus, a defendant who believes he is innocent of the antitrust charges against him can afford to go to trial to prove that he is not guilty without the usually insupportable risk that he would be liable for all the damages flowing from the violation as with the present rule. I believe that S.1300 will result in a reduction of the number of specious antitrust actions. These are often brought only with the idea of a coerced settlement by unscrupulous lawyers seeking attorney's fees or a part of the settlement and not for the redress of a real wrong. I urge the Administration to again consider supporting S.1300.

With respect to the provision permitting the Government to recover treble damages, I believe the Government already has sufficient enforcement tools to prevent antitrust violations. The Government can recover criminal penalties and these are no longer insignificant. In addition, the possible application of Rico Statutes in appropriate cases adds to the Government's ability to obtain penalties. The treble damage provision was designed not only as a deterrent but also to motivate the private sector to help enforce the antitrust laws. The Government should need no such incentive to perform its clear duty. The present rule which allows the Government to recover untrebled damages, I believe is sufficient.

I support your effort to limit treble damages to "hardcore" antitrust violations. However, under your proposal all cases involving overcharges or undercharges would still incur treble damages. This would include not only price-fixing but verticle cases and those under the Robinson-Patman Act against a manufacturer by its distributors, dealers or customers. Very often this type of case can involve aggressive pricing or marketing situations. These cases may well involve just the sort of pro-competitive conduct which the Government is trying to encourage yet they would still be subject to the inhibiting effect of the treble damage penalty.

Concerning attorneys' fees, prevailing plaintiffs, for years, have been accorded a right to reasonable attorneys' fees. If this rule is to be expanded, I believe that it would be fairer to accord a prevailing defendant with a right to attorneys' fees, without subjecting the question to the uncertainties of individual judges' viewpoints. Surely the incentives for a plaintiff to file an antitrust case would still exist if both plaintiffs and defendants were given attorneys' fees if they win - and the risk of having to pay such fees might deter a plaintiff otherwise inclined to file a less than bonafide claim.

Merger Modernization Act of 1986. Mobil strongly supports your proposal to amend Section 7 of the Clayton Act to define and clarify the standard by which acquisitions are judged and to incorporate the analysis under the 1984 Merger Guidelines so that only mergers which are actually anticompetitive are prohibited.

Foreign Trade Antitrust Improvements Act of 1986. As a company which competes internationally, Mobil strongly endorses your proposal to lessen the conflict between U.S. antitrust law and the legitimate interests of other nations. You might consider the provision in Senator DeConcini's bill, S.397, to limit recovery to actual damages plus prejudgment interest and attorneys' fees if that would substantially reduce the conflict with another nation.

Promoting Competition in Distressed Industries Act. While I welcome your attempt to limit any protectionist measures, I am not sure that permitting mergers, which would otherwise be prohibited, will help any industry be more competitive especially where its profitability has been threatened or undercut by an influx of cheap foreign imports. The idea of any company wanting to make an acquisition in an industry where profits are low enough to cause recourse to the International Trade Commission is one I have difficulty in understanding. Moreover, the conditions laid down by the proposal for obtaining a certificate of exemption make it highly unlikely that a company would ever obtain such a certificate in time to do it any good.

In conclusion, let me again state Mobil's strong support for your important efforts to enact meaningful antitrust reform. Thank you for your consideration of my comments.

Sincerely yours,

Allen E. Murray

Allen E. Murray

Monsanto

RICHARD J. MAHONEY
President and
Chief Executive Officer

Monsanto Company
800 N. Lindbergh Boulevard
St. Louis, Missouri 63167
Phone: (314) 694-3756

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'86 MAR 17 P2:27

March 13, 1986

The Honorable Malcolm Baldrige
Secretary of Commerce
Department of Commerce
Washington, D.C. 20230

Dear Mac:

Your initiatives in seeking to reform America's outdated antitrust laws are admirable. We need to find ways to improve our nation's competitiveness, especially when the end of our high trade deficits is not yet in sight. Antitrust laws have long been on the list of "needed actions" identified by many companies and business groups. I certainly support your efforts and have asked our Washington Office to do likewise.

Sincerely,

Dick

Richard J. Mahoney

RJM/cc

cc: The Honorable Edwin Meese, III
Attorney General

The Honorable James A. Baker, III
Secretary of The Treasury

Navistar International
Corporation

401 North Michigan Avenue
Chicago IL 60611
312 836 2600

Donald D Lennox
Chairman of the Board and
Chief Executive Officer

March 20, 1986

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'86 MAR 24 A10 :48

The Honorable Malcolm Baldrige
The Secretary of Commerce
14th St. & Constitution Ave., N.W.
Washington, D. C. 20230

NAVISTAR

Dear Mr. Secretary:

I strongly support the proposed antitrust law reforms. Enactment of these reforms will enhance the ability of U.S. firms to compete effectively on a global basis.

The current law on mergers and acquisitions focuses too much on theoretical possibilities and too little on real competitive impact. Adding to the problem, the unpredictability of litigation results under the current law discourages many transactions that could well be pro-competitive.

With respect to treble damage awards, I understand the desire to retain that deterrent in egregious situations, but I am concerned that the reforms may leave open the possibility of windfalls in price discrimination cases, where a plaintiff claims "overcharge." In my view, damage awards under that highly technical and frequently anticompetitive statute should not be trebled under any circumstances.

I also have some concern that the proposed prejudgment interest provisions will complicate lawsuits that are already too complex and may also give rise to the type of windfall awards that would otherwise be curtailed by the limitations on treble damages. Consequently, I believe interest should accrue from the filing of a lawsuit, not from some earlier and often uncertain date.

Finally, I endorse enthusiastically the reforms that will discourage frivolous cases, unnecessary pretrial discovery and unconscionable settlement negotiation tactics.

[redacted] enact the

Sincerely,

INTERNATIONAL

613081

April 18, 1986

'86 APR 24 AM 10 53

The Honorable Malcolm Baldridge
Secretary of Commerce
Washington, D. C. 20230

Dear Mr. Baldridge:

You recently forwarded to my office the Administration's Proposed Legislative Reforms to the United States antitrust laws.

After reviewing these proposed reforms carefully, I fully support the Administration's efforts in this endeavor. One of this nation's top priorities must be the reestablishment of U.S. firms as effective participants in the global economy. Reforms of this sort are necessary steps to the reemergence of this country as an international economic force.

Outboard Marine Corporation has committed substantial resources to projects and strategies intended to ensure that our competitors, including the Japanese, adhere to the principles of free trade. We are dedicated to the premise that no competitor should be permitted to gain any advantage through unfair or illegal marketing practices anywhere in the world.

I applaud the Administration's initiative in this important area and thank you for your consideration in forwarding these materials to me.

Sincerely,

CD Strang

C. D. Strang, Chairman
and Chief Executive Officer

CDS/dls

Paul G. Schloemer
President &
Chief Executive Officer

611405

'86 MAR 10 P

Cleveland, OH 44112
Telephone 216 531 3000

The Honorable Malcolm Baldridge
Secretary of Commerce
Washington, D.C. 20230

March 6, 1986

Dear Secretary Baldridge:

We appreciate your sending us the President's proposed legislative reforms and accompanying briefing papers concerning our federal antitrust laws. We at Parker-Hannifin Corporation certainly endorse the Administration's attempt to revise the antitrust laws to reflect the realities of the global marketplace in which American firms must now compete. We are particularly supportive of the proposed revisions which would require federal courts to take such important factors as foreign competition and barriers to new entry into account when determining the legality of various business combinations under the antitrust laws.

Sincerely,

Paul G. Schloemer

Paul G. Schloemer

PGS/mjw

cc: The Honorable James A. Baker, III
Secretary of the Treasury

The Honorable Edward Meese, III
United States Attorney General

Pfizer

PFIZER INC. 235 EAST 42nd STREET, NEW YORK, N.Y. 10017

EDMUND T. PRATT, JR
Chairman of the Board

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'86 APR -3 P3:33

March 26, 1986

The Honorable Malcolm Baldridge
The Secretary of Commerce
Washington, D.C. 20230

Dear Mac:

You, Attorney General Meese and Secretary Baker asked for our comments on the Administrations' proposed legislative antitrust reforms. The Policy Committee of the Business Roundtable, on which I serve, has discussed this proposed legislation and issued a policy position on March 13 (copy enclosed).

We believe that the Roundtable's position is a good one, and we support it. I look forward to working with the other Roundtable members to achieve the antitrust reform needed to enhance the competitiveness of United States companies in the worldwide market.

Sincerely yours,

E. T. Pratt, Jr.

Shell Oil Company

One Shell Plaza
P. O. Box 2463
Houston, Texas 77001

John F. Bookout
President
Chief Executive Officer

3051

April 15, 1986

'86 APR 24 A10:53

Honorable Malcolm Baldrige
Secretary of Commerce
Washington, D. C. 20230

Dear Mr. Secretary:

Thank you for your letter of February 25, 1986, forwarding the Administration's proposed changes to our antitrust laws. We appreciate very much the Administration's initiative in addressing needed antitrust reforms.

As you know, the legislative proposals are under consideration and review at this time by various business and trade associations of which we are a member, such as the Chamber of Commerce and The National Association of Manufacturers. We expect to participate in their review and will support the Administration's proposals through these organizations and through the Business Roundtable, whose Policy Committee at its March meeting endorsed the Administration's proposals and announced plans to work with the Administration and Congress to pass this needed legislation.

Again, I thank you for your letter and we would be pleased at your request to meet with you and Messrs. Baker and Meese, or your representatives to discuss these proposals.

Sincerely yours,

John Bookout

cc - Honorable James A. Baker III
Honorable Edwin Meese III

4/28/86 10:00am

SPERRY CORPORATION
1290 AVENUE OF THE AMERICAS
NEW YORK, NEW YORK 10104

JOHN P. KARALIS
Senior Vice President
and General Counsel

April 21, 1986

613165

The Honorable James A. Baker III
Secretary of the Treasury
Fifteenth Street & Pennsylvania Avenue, N.W.
Washington, D. C. 20220

The Honorable Malcolm Baldridge
Secretary of Commerce
Washington, D. C. 20230

The Honorable Edwin Meese III
Attorney General
Constitution Avenue & Tenth Street, N. W.
Washington, D. C. 20530

Gentlemen:

Mr. Gerald G. Probst, Chief Executive Officer of Sperry Corporation, has asked me to reply to your letter of February 25, 1986 on the President's proposals to reform the antitrust laws.

We have reviewed the enclosures and wholeheartedly support the proposals. Their adoption would make an outstanding contribution to the improvement of our nation's antitrust laws. Our specific thoughts are as follows.

The Merger Modernization Act of 1986 would amend Section 7 of the Clayton Act to require evidence of a significant probability that the merger will have harmful effects. We agree that this more precise statutory definition would not only help assure continuity in Government enforcement actions over the years, but would also place potential private plaintiffs under the same test as that applied by the Government.

The Antitrust Remedies Improvements Act of 1986's proposed amendment to the treble damage provisions of Section 4 of the Clayton Act would encourage competition. Among other things, it would discourage lawsuits brought in the hope of dampening competition with the plaintiff.

Unsuccessful plaintiffs should be required to pay defendants' attorneys fees. Therefore, Title III of the Antitrust Remedies Improvement Act would be a step in the right direction.

Today, a defendant who is an alleged antitrust conspirator has tremendous pressures upon him to settle because of the existence of joint and several liability. If he does not settle and others do, he may be left with an enormous litigation exposure. The claim reduction proposals of Title IV would restore a fair balance to the settlement process.

The Foreign Trade Antitrust Improvements Act of 1986 would help bring about a sound approach to the application of our antitrust laws to international business transactions.

The long overdue proposed revision of Section 8 of the Clayton Act on interlocking directors in the Interlocking Directorate Act of 1986 should be noncontroversial. It deserves the unanimous support of the Congress.

Lastly, the Promoting Competition in Distressed Industries Act should strengthen the position of American industry without violating GATT or encouraging protectionism abroad.

If there is anything we can do to support the President, please do not hesitate to call upon us. We want to help secure the enactment of his proposals.

Respectfully

John P. Karalis

cc: Mr. Gerald G. Probst

612506

SQUIBB
Corporation

P.O. Box 4000
Princeton, NJ 08540-0130
609 921-5276

Richard M. Furlaud
Chairman and
Chief Executive Officer

'86 APR 11

April 8, 1986

The Honorable Malcolm Baldrige
Secretary of Commerce
Department of Commerce - Room 5851
Herbert C. Hoover Building
14th Street and Constitution Avenue, N.W.
Washington, D.C. 20230

Dear Mr. Secretary:

We, at Squibb, enthusiastically support your proposed legislative reforms of the antitrust laws. We support the need for such reforms and congratulate you for your foresight in making the proposals.

We also would like to compliment Assistant Attorney General Ginsberg for his recent testimony before the House Subcommittee on Monopolies and Commercial Law.

We wish you success in this endeavor.

Very truly yours,

Richard M. Furlaud

Copy: The Hon. Edwin Meese, III
Attorney General
Department of Justice - Room 5111
10th Street & Constitution Ave., N.W.
Washington, D.C. 20530

The Hon. James A. Baker, III
Secretary of the Treasury
Department of the Treasury - Room 3330
15th Street and Pennsylvania Ave., N.W.
Washington, D.C. 20220

UNIROYAL

UNIROYAL, Inc.
World Headquarters
Middlebury, Connecticut 06749

203-573-3095

JOSEPH P. FLANNERY
Chairman, President and Chief Executive Officer

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'86 APR -3 P3:28

March 31, 1986

The Honorable
Malcolm Baldrige
The Secretary of Commerce
Washington, D.C. 20230

Re: Amendments to the Antitrust Law

Dear Secretary Baldrige:

Thank you for your letter of February 25th. I strongly endorse the proposed amendments.

I have had personal experience, both as one who has invited others to sit on our board of directors and one who has been invited to serve on boards of other companies, with the extraordinary and unwarranted expenditure of executive and attorney time involved in looking for and dealing with trivial competitive overlaps that could have no real antitrust significance. Your amendment in this area will remove an obstacle to getting the best people to serve on a company's board.

In a couple of instances, I do not think that the amendments go far enough.

In addition to providing for recovery of attorneys' fees by successful defendants in frivolously brought antitrust cases, which I applaud, I wonder if you shouldn't pursue the same thought for all cases brought in federal court, especially frivolous product liability and personal injury cases where we need all the help we can get to stop spiraling insurance costs and strike suits. It's time unreasonable plaintiffs and their attorneys had something to worry about.

I support your intent to eliminate treble damages for aggressive low pricing under the Sherman Act. However, my attorneys tell me that the language used to limit that remedy would still permit treble damages for simple price differences under the Robinson-Patman Act. That seems like an inconsistent result, especially when the reason for eliminating treble damages for aggressive pricing is that it is "potentially procompetitive." Simple price differences are more procompetitive because they are generally more widely available and not aimed against a particular company. There is no reason to continue treble damages for simple price discrimination, if such damages are to be eliminated for aggressive (or what used to be called predatory) low pricing.

Sincerely yours,

Joseph P. Flannery

Joseph P. Flannery

cc: James A. Baker

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WORTHINGTON INDUSTRIES, INC.

March 17, 1986

'86 MAR 19 P3:55

Mr. Malcolm Baldrige
Secretary of Commerce
14th Avenue between E. State
and Constitution Avenue
Washington, D.C. 20230

Dear Mr. Baldrige:

Thank you for sending me the information on the administration's proposed legislation to reform and accompanying briefing papers relating to the United States antitrust laws. I will not attempt to comment on any of the details of the proposal, as I am sure it will receive a flurry of analysis in the months ahead. However, I did want to write and express my support for the administration's efforts to revise the antitrust laws to reflect the realities of today's markets.

As you have pointed out, the economic conditions have changed since the antitrust laws were adopted. The United States no longer dominates world commerce and an international market truly exists. American companies should not be hamstrung in their efforts to meet foreign competition.

Any changes in the antitrust law which recognize the realities of worldwide competition and attempt to reduce the unpredictability now existing under current law will certainly be welcome to American business. Your efforts appear to be addressing these problems while still providing sufficient protection against the worst types of abuses.

I wish you success in your efforts.

Very truly yours,

John H. McConnell

1205 DEARBORN DRIVE · COLUMBUS OHIO 43085 · PHONE 614/438-3210
WORTHINGTON STEEL · COLUMBUS OH · LOUISVILLE KY · FRANKLIN PARK IL · ROCK HILL SC · BALTIMORE MD · MONROE OH
BUCKEYE INTERNATIONAL INC · COLUMBUS OHIO
WORTHINGTON CYLINDERS · COLUMBUS OHIO
U BRAND CORPORATION · ASHLAND OHIO
ADVANCED COATING TECHNOLOGY INC · FRANKLIN TENNESSEE

THE ASSOCIATION OF THE BAR
OF THE CITY OF NEW YORK
42 WEST 44TH STREET
NEW YORK 10036

COMMITTEE ON ANTITRUST AND TRADE REGULATION

GUY MILLER STRUVE
CHAIR
1 CHASE MANHATTAN PLAZA
NEW YORK 10005
212 530-4192

DANIEL L. BROCKETT
SECRETARY
1 CHASE MANHATTAN PLAZA
NEW YORK 10005
212 530-4250

June 9, 1986

Re: Merger Modernization Act
of 1986 (H.R. 4247, S. 2160)

Kenneth Starling, Esq.
Antitrust Counsel
Committee on the Judiciary
United States Senate
SD-224 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Ken:

Enclosed is a copy of a report prepared by the Committee on Antitrust and Trade Regulation of the Association of the Bar of the City of New York concerning the Merger Modernization Act of 1986, which has been proposed by the Administration as part of its package of proposed antitrust legislation (H.R. 4247, S. 2160).

For the reasons set forth in the report, the Committee (with five members dissenting in whole or in part) believes that the Act should not be enacted. The Committee believes that it would be unfortunate to freeze in the statutory language of Section 7 of the Clayton Act the views of merger economics and enforcement policies that prevail in the Antitrust Division from time to time. The Committee further believes that a convincing case has not been made for altering the language of Section 7 of the Clayton Act from the language which has prevailed essentially unchanged since the Kefauver Amendments of 1950.

Please let me know if there is any further information which our Committee can supply concerning this important issue.

Sincerely yours,

Guy Miller Struve

ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK COMMITTEE ON ANTITRUST AND TRADE REGULATION

REPORT ON THE MERGER MODERNIZATION ACT OF 1986

Introduction

The Administration has proposed, and Congress is currently considering, the Merger Modernization Act of 1986 ("the Act").[1] The Act would amend section 7 of the Clayton Act in three significant respects:

1. The Act replaces the "may be" and "tend to" language in section 7 with the requirement that there be a "significant probability" that a merger will be harmful before it is found illegal.
2. The Act replaces the "substantially lessen competition" or "create a monopoly" language with a more precise economic formulation, namely, that a merger "substantially increase the ability to exercise market power." The Act defines market power as "the ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time."
3. The Act directs the courts, when appraising a merger's probable effect on market power, to consider several specific, non-exclusive factors.

Although the Committee believes that the economic approach to analyzing mergers that the Act reflects is for the most part sound, it nonetheless opposes these amendments to section 7. Both government enforcement policy and recent judicial applications of section 7 are largely consistent with the Act's approach, so it does not appear that the Act will remove any ill-conceived impediments to desirable mergers. On the other hand, the Act may disserve the goal of preventing anticompetitive mergers by wedding merger policy to the economic paradigms that are broadly accepted in 1986 and thereby insulating it from advances in economic thought.

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[1] The Act was introduced in the House of Representatives as H.R. 4247 and in the Senate as S. 2160.

Background

It has long been recognized that mergers may reduce the competitiveness of the marketplace, and the regulation of mergers and acquisitions has been a matter of congressional concern for almost one hundred years. At the turn of the century, the country experienced a merger wave that provoked considerable public debate. While the government was able to employ the Sherman Act to challenge mergers that created combinations of monopolistic proportions,[2] most mergers were deemed to be permitted by existing law.

Merger regulation was a major issue in the election of 1912. After the election of President Wilson in that year, Congress considered numerous enhancements to the antitrust laws and ultimately passed the Clayton Act in October of 1914. Section 7 of the original Clayton Act prohibited stock acquisitions "where the effect of such acquisition may be to substantially lessen competition." According to the Senate Report on the Act, the purpose of statute was "to arrest the creation of trusts, conspiracies, and monopolies in their incipiency and before consummation." Between 1914 and 1950, however, merger enforcement was almost nonexistent. Most companies were able to avoid the Act's strictures simply by engaging in asset, as opposed to stock, acquisitions. In 1950, with the passage of the Celler-Kefauver amendment, Congress finally plugged "the assets loophole."

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[2] E.g., Northern Securities Co. v. United States, 193 U.S. 197 (1904).

Since 1950, the Clayton Act has been the principal vehicle through which the government and private parties have challenged mergers that threaten to have anticompetitive effects. Not all mergers, however, are anticompetitive, and the Committee believes that the antitrust laws should not be used to impede mergers that are competitively benign or neutral. By (1) tightening up the incipiency test and (2) focusing the inquiry on whether a merger is likely to result in supracompetitive prices, the Merger Modernization Act seeks to ensure that the antitrust laws "not interfere with the ability of American firms freely to reorganize through mergers and acquisitions that enhance productivity, innovation, and world-wide competitiveness." U.S. Dep't of

Justice, "Merger Modernization Act of 1986," Analysis (February 19, 1986) ("DOJ Analysis") at 1.

Analysis of the Proposed Amendments

A. The "Significant Probability" Test

By explicitly providing that a merger violates section 7 only where there is a "significant probability" that it will have anticompetitive effects, the Act seeks to insure that mergers are not prevented based upon the remote possibility that they will diminish competition. Although the Committee agrees that mergers should not be prohibited based on remote or ephemeral possibilities of harm, it does not believe that legislation is needed to safeguard against that possibility. The current judicial construction of section 7 requires a plaintiff to prove more than a remote possibility of anticompetitive effect if it is to prevail.

In Brown Shoe Co. v. United States, 370 U.S. 294, 323 (1962), the Court, in analyzing the legislative history of section 7, observed: "[N]o statute was sought for dealing with ephemeral possibilities. Mergers with a probable anticompetitive effect were to be proscribed by this Act." The Administration, in proposing the "significant probability" standard, recognized that "[b]oth Congress and the Supreme Court have construed [the current section 7] language to mean that before a merger may be condemned, a reasonable probability or reasonable likelihood that it will substantially lessen competition must be shown." DOJ Analysis at 3. That being the case, there is little risk that mergers will be prohibited based upon the remote likelihood of anticompetitive effects. In fact, a review of the decisions applying section 7 reveals that the courts consistently require more than a showing of a remote possibility of harm.

It is, of course, possible that a particular court might prohibit a merger based upon a fairly low probability of anticompetitive effect. The Committee, however, is not aware of any such cases in recent years, and citations to such cases are conspicuous by their absence in the DOJ Analysis. Thus, it is not clear that there is any problem to be redressed by the "significant probability" language. Moreover, if there were a problem, it is not clear that this language would solve it. It is not obvious whether a 70 percent, 50 percent, 30 percent, or 10 percent probability of anticompetitive effect would be necessary to satisfy the "significant probability" standard. Nor is it obvious whether the dividing line between significant and insignificant probabilities is the same for all cases, or whether, instead, it depends on the gravity of the possible anticompetitive effects.[3] Given this ambiguity, a court that would under current law prohibit a merger based upon a fairly remote showing of harm would probably be able to construe the "significant probability" standard so as to prohibit the merger as well.[4]

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[3] For example, a five percent probability of rain is probably not "significant" for many purposes, but a five percent probability of being murdered if one walked through a given park at night would surely be "significant" when planning the route one will walk. Similarly, a low probability of very severe anticompetitive effects might be deemed "significant" whereas a higher probability of minor anticompetitive effects might be deemed not "significant."

B. Market Power Analysis

Section 7 is aimed at mergers whose effect "may be to substantially lessen competition, or tend to create a monopoly." As drafted, section 7 is quite flexible. The Act would impose a more precise test and specify how the courts should go about applying it.

Under the Act, the analysis of a merger under section 7 would focus on its impact on "market power." The Act, in turn, defines market power as "the ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time." It would require a court, in appraising the likelihood that a merger will enhance market power, to consider:

> "all economic factors relevant to the effect of the acquisition in the affected markets, including (i) the number and size distribution of firms and the effect of the acquisition thereon; (ii) ease or difficulty of entry by foreign or domestic firms; (iii) the ability of smaller firms in the market to increase

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[4] Moreover, there is a risk that the very act of amending section 7 would be construed by some courts as a congressional indication that they should apply a higher standard than the "reasonable probability" standard they apply today. If courts respond to the new language by requiring something akin to a showing by clear and convincing evidence that a merger will diminish competition, the effect of the amendment may be to permit mergers to go ahead despite the fact that they probably will substantially lessen competition.

> production in response to an attempt to exercise market power; (iv) the nature of the product and terms of sale; (v) conduct of firms in the market; (vi) efficiencies deriving from the acquisition; and (vii) any other evidence indicating whether the acquisition will or will not substantially increase the ability, unilaterally or collectively, to exercise market power."

The amendments are intended to eliminate nebulous socio-political considerations as a basis for challenging a merger and to make clear that section 7 "is intended to preserve competition, rather than competitors per se." DOJ Analysis at 5.

The Committee agrees that section 7 should be directed only at mergers that threaten competition and should not prohibit mergers that injure or eliminate particular competitors without reducing the competitiveness of the marketplace. This proposition, however, has been embraced by the enforcement agencies and has received virtually universal endorsement by the courts.[5] Accordingly, there is little, if any reason to clarify the Clayton Act's concern with competition as opposed to competitors.

Admittedly, in the first decade or two following the Celler-Kefauver amendment, section 7 was applied so as to prohibit certain mergers that, in retrospect, appear likely to have diminished only the number of competitors, not the vigor of competition.[6] Such decisions were the product of the economic thinking prevalent at the time that tended to assume that virtually any increase in the concentration of a market was likely to diminish competition. The courts drew upon this body of economic thought to create the judicial presumption that even small increases in concentration in an already concentrated market were likely to diminish competition and, therefore, violated section 7. See United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963).

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[5] E.g., Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962) ("legislative history illuminates congressional concern with the protection of competition, not competitors") (emphasis in original).

Economic theory, however, did not stand still. Many economists questioned the simple equation of high concentration ratios and non-competitive behavior that had been the underpinning of section 7 analysis throughout the 1960's and the early 1970's.[7] In particular, many economists questioned whether even a highly concentrated market would behave non-competitively if entry was relatively easy. The "Chicago School" of economic thought, which extolled the working of the free market and admonished against government interference with it, argued that mergers were almost always motivated by such considerations as achieving efficiencies and could rarely confer market power. Economists also questioned the meaningfulness of the traditional approach to market definition, which often excluded foreign producers when computing concentration ratios. In short, while economists continued to be concerned with market concentration, they were more inclined than they had been to consider other factors as well when appraising how a merger is likely to affect the behavior of a concentrated market.

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[6] E.g., United States v. Von's Grocery Co., 384 U.S. 270 (1966).

[7] See generally H.J. Goldschmidt, H.M. Mann, J.F. Weston, Industrial Concentration: The New Learning (1974).

These developments in economic thinking were not lost on section 7. During the 1970's, the enforcement agencies began to temper the application of a simplistic concentration analysis with consideration of a variety of other factors. In 1982, the Department of Justice issued a revised set of antitrust guidelines which embraced much of the new economic learning, and the Federal Trade Commission issued a statement of its merger enforcement policy that reflected a similar economic philosophy. In 1984 the Department of Justice issued a slightly modified set of merger guidelines, and the Act is a proposed codification of the guidelines' essential principles. Thus, it seems clear that the passage of the Act would have virtually no effect on existing enforcement policy.

Nor is it likely that the Act will significantly affect the private enforcement of section 7. In recent years the courts have increasingly embraced the teachings of contemporary economics and several of the principles upon which the Act is based.[8] In particular, it seems well-established that the ease or difficulty of entry is a significant factor in appraising the competitiveness of markets[9] and that foreign producers should be considered when defining markets or identifying potential entrants.[10] That private suits do not seriously impede pro-competitive mergers is readily apparent. Despite the hundreds of mergers that occur each year, the Committee is aware of very few recent cases in which a private party obtained relief under section 7.[11] Moreover, it is not apparent that those courts would have reached different conclusions had the Act been in effect.

While the Act would have little effect on the current application of section 7, the Act poses one significant danger: it threatens to insulate section 7 from any evolution in the economic analysis of mergers. One of the principal virtues of section 7 is its flexibility. Because it is targeted at mergers that "lessen competition," it allows the courts to draw upon the evolving body of economic knowledge to appraise whether a merger will in fact lessen competition. The Act, by redefining the section 7 test in terms of market power, codifies the currently popular view of what constitutes a lessening of competition. In doing so, it precludes consideration of any dimension of competition other than price, despite the fact that such factors as product quality and technological innovation are of great significance to the consumer.

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[8] E.g., United States v. General Dynamics Corp., 415 U.S. 486 (1974) (despite high level of concentration, merger unlikely to diminish competition in light of other evidence).

[9] See United States v. Waste Management, Inc., 743 F.2d 976 (2d Cir. 1984).

[10] See Yamaha Motor Co. v. FTC, 657 F.2d 971 (8th Cir. 1981), cert. denied, 456 U.S. 915 (1982).

[11] The question of a firm's standing to challenge under section 7 a merger of its competitors is currently before the Supreme Court. See Monfort of Colorado, Inc. v. Cargill, Inc., 761 F.2d 570 (10th Cir. 1985), cert. granted, 54 U.S.L.W. 3460 (U.S. Jan. 14, 1986) (No. 85-473). The resolution of this issue might further diminish any fear that private suits will inhibit desirable mergers.

The danger of codifying a very precise standard to be applied by the courts is obvious. Had section 7 been redrafted in the 1950's or 1960's to incorporate the then-prevailing economic wisdom, the courts would today find it difficult to incorporate contemporary economic principles into section 7. Although the economic analysis of mergers has become much more sophisticated over the past few decades, it would be naive to presume that the final chapter has been written.[12] While merger analysis today focuses largely, if not exclusively, on the likely effect of a merger on the ability to price above the competitive level, it is conceivable that non-price dimensions of competition could assume a more prominent role in merger analysis. For example, economics may someday provide a framework for analyzing the costs of reduced product diversification, even if unaccompanied by higher prices. If section 7 were amended as proposed, however, such effects could not be considered because they would fall outside the price-oriented statutory test.[13] The Committee believes that it would be a mistake to freeze the evolution of section 7 by codifying the economic conception of "diminished competition" that happens to prevail in 1986.

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[12] Even today, while certain tenets of the new economic learning (such as the significance of analyzing entry conditions) are accepted almost universally, other aspects generate vigorous debate and are questioned by well-respected economists.

Although the Committee's objection to the Act is based principally on the dangerous and unnecessary rigidity that it would impose on section 7, there is one additional aspect of the Act that troubles the Committee. The Act directs the courts to consider the "efficiencies deriving from the acquisition" when appraising the likelihood that a merger will enable firms to set prices above a competitive level. There is no obvious relationship, however, between the realization of efficiencies and the maintenance of competitive prices, since the "competitive" price is defined in economic terms as being equal to some measure of cost.[14] Indeed, it is not clear whether the presence of efficiencies makes it more likely or less likely that non-competitive prices will be charged. Thus, "efficiencies" is out of place as a factor to be considered in appraising the likely effect of a merger on market power.

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[13] This problem is not rectified by factor (vii) which allows the court to consider certain evidence other than that identified in factors (i)-(vi), because it embraces only evidence that bears upon "the ability . . . to exercise market power."

Some commentators have urged that an efficiencies defense be adopted so that an anticompetitive merger would not contravene section 7 if it created substantial efficiencies that outweighed its adverse effect on competition.[15] The discussion of efficiencies in the DOJ Analysis (at 10-11) seems to suggest that efficiencies be recognized as a defense. Whether there should be an efficiencies defense under section 7 is a complex question, and it gives rise to a host of issues concerning the type of efficiencies that should be considered, the quantum of proof required of the defendant, and the manner in which efficiency benefits are to be balanced against the cost of decreased competition.[16] Whatever the merits of such a defense, the Act does not create one; it merely directs that efficiencies be considered in analyzing market power. Indeed, the Act explicitly precludes the recognition of an efficiencies defense to an anticompetitive merger, since it makes the likelihood of non-competitive pricing the sole test of legality. Once the likelihood of non-competitive pricing is demonstrated, a merger would be illegal no matter how significant the efficiencies it produces.[17]

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[14] For example, if all the firms in a market became more efficient, their decreased costs would lead to a reduction in the competitive price. There is no reason to suspect, however, that these firms would set their prices less above the new competitive price than they previously set them above the old competitive price. Thus, efficiencies tend to result in lower prices, but not necessarily more "competitive" prices.

[15] E.g., Muris, "The Efficiency Defense Under Section 7 of the Clayton Act," 30 Case Western Reserve L. Rev. 381 (1980).

Thus, the Act's treatment of efficiencies is unsound and likely to generate confusion. As a factor to be considered in analyzing market power, the efficiencies to be produced by the merger are of little if any relevance. If efficiencies are to be considered it should be as a defense, but the Act does not create an efficiencies defense. Moreover, absent a showing of the need for and practicality of an efficiencies defense, section 7 should not be amended to permit anticompetitive mergers. Accordingly, if the Act is to be passed, the "efficiencies deriving from the acquisition" should be stricken as one of the factors to be considered.

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[16] For example, the defense might be limited to cases in which the probability or likely magnitude of a diminishment of competition is modest, or it could permit any degree of likely anticompetitive effect to be overcome by a showing of suitably large efficiencies.

[17] If the Act were construed to permit the consideration of efficiencies independent from their effect on market power, it might be interpreted to mean that the inability to prove that a merger will produce efficiencies will be a negative factor that may dictate that a merger be prohibited, a result probably at odds with the Act's intent.

Conclusion

The Act reflects a fundamentally sound economic approach to the analysis of mergers. That approach, however, is already reflected in both enforcement practices and judicial decisions. Thus, the Act offers little practical benefit. The ultimate proof lies in the fact that in recent years, despite an enormous number of mergers (including several between the 100 largest companies in the United States), section 7 has been applied to prohibit only a handful of mergers. In light of this track record, moreover, it is difficult to believe that rational businessmen have been deterred from many, if any, efficiency-creating mergers. In sum, the Act would do little to enhance the application of section 7 today.

In contrast, the Act threatens to impede the application of section 7 in the future by wedding it to the current state of economic knowledge and precluding courts from absorbing from the evolving discipline of economics more sophisticated concepts of what constitutes a diminishment of competition. Although that danger might be worth assuming if it were the necessary cost of avoiding a rash of economically imprudent decisions that prohibited desirable mergers, it is not worth assuming given the track record of section 7 in recent years. Accordingly, the Committee opposes the adoption of the Merger Modernization Act of 1986.

Committee on Antitrust and Trade Regulation

Guy Miller Struve, Chair

Joseph Angland*
I. Scott Bass
Betty Bock (adjunct member)*
James W. Bowers
Raymond Brenner
Richard E. Carlton****
Edward D. Cavanagh
Steven M. Edwards**
Harry First
Richard A. Givens
Thomas P. Griesa****
Richard L. Hoffman
Allen S. Joslyn*
Lewis A. Kaplan
Kenneth M. Kramer
Theodore R. Kupferman
Norma B. Levy
Robert Neuner
Craig Schiller
Zachary Shimer
William F. Sondericker***
Alvin M. Stein
Richard M. Steuer
Neal R. Stoll
George A. Vradenburg III
Clark E. Walter
Bonnie G. Wittner
Kimba M. Wood****

New York, New York

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* Members of the Subcommittee that prepared this report.

** Mr. Edwards has filed a concurring statement.

*** Mr. Sondericker has filed a concurring and dissenting statement.

**** Mr. Carlton has filed a dissent in which Judge Griesa joins. Ms. Wood also dissents.

Committee on Antitrust and Trade Regulation
Report on the Merger Modernization Act of 1986

Concurring Statement of Steven M. Edwards

I concur with the Committee's report on the Merger Modernization Act of 1986 but would like to add a few thoughts of my own.

The major defect of the proposed legislation, in my view, is its preoccupation with price as the only indicium of market power. While the question whether a merger may result in an increase in price is important in analyzing its effects, the question whether a merger may diminish quality or reduce innovation is also important. The price of buggy whips in 1850 makes little difference to me today; the invention of the automobile makes all the difference in the world.

To be sure, economists have not developed any meaningful tools for measuring the impact of a merger on quality or innovation, but they have not developed any meaningful tools for measuring the impact of a merger on price either. They are simply preoccupied with price because it is easier to quantify than quality or innovation. It is fair to say that economics, as a science, is in its infancy. Therefore, I agree with the Committee's view that there is no reason to cast today's popular economic theory in the concrete of law.

I disagree with the Committee's view that, if the Act is to be passed, efficiencies should be stricken as one of the factors to be considered. Efficiencies, in my view, are one of the most important factors to consider in analyzing the impact of a merger. The real achievement of the present merger guidelines is the inclusion of efficiencies as a factor to be considered in addition to market share.

The Committee reasons that, once the likelihood of non-competitive pricing is demonstrated, a merger should be illegal no matter how significant the efficiencies it produces. That assumes, however, that a likelihood of non-competitive pricing can be demonstrated in particular cases. That is simply not true using the analytical tools available today.

Using the analytical tools available today, the most we can determine about a merger is whether it increases concentration and whether barriers to entry exist. Having made that determination, we do not know whether non-competitive pricing will result. We simply assume that, if a merger significantly increases concentration in a market with high barriers to entry, non-competitive pricing is more likely than before.

In evaluating the strength of that assumption, it makes sense to consider whether the merger will have any positive effect. While the Committee may be correct in asserting that it is more logical to consider efficiencies as a defense (as opposed to a factor that decreases the likelihood of an enhancement of market power),* the position that this factor occupies in the analytical scheme is not that important. The important point is that if the Clayton Act is to be amended, efficiencies should be a factor to consider in determining whether a merger should be prohibited.

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* It should be noted that the Act, as drafted, does not provide any guidance as to which way efficiencies should cut. It is possible to interpret the Act as providing that the enhancement of efficiencies militates in favor of a challenge. It is also possible to interpret the Act as providing that the absence of efficiencies militates in favor of a challenge. This should be clarified.

Committee on Antitrust and Trade Regulation
Report on the Merger Modernization Act of 1986

Concurrence and Dissent of
William F. Sondericker

I concur in the Committee's opposition to the adoption of the proposed amendment. Also, I would reject the Administration's proposed test of "significant probability" as ambiguous.* Nevertheless, I support the Administration's view of the desirability of an amendment of the law, and, in particular, that part of Section 7 of the Clayton Act that deals with the applicable standard of proof. I would therefore amend the present "may be" and "tend to" incipiency test and, as discussed below, would replace that test with a test of "clear and convincing evidence of a probability" that a merger "will substantially lessen competition or create a monopoly", before finding that the merger would violate Section 7.

The proposed test of "significant probability" appears intended to make the standard of proof higher.

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* It would appear that the word "significant" should more appropriately apply as an alternative in another part of Section 7, i.e. "significantly lessen" versus "substantially lessen."

In my view, the "clear and convincing" standard is a better way to accomplish that purpose. The judicial process customarily deals in probabilities. Judges and juries do not have personal knowledge of their own as to what actually happened (or might happen), and thus, in order to reach a decision or verdict, usually must decide what "probably" occurred. The same kind of _ratio decidendi_, can be applied to the important area of business mergers.

Moreover, the clear and convincing standard is well recognized for use in civil cases. _Addington v. Texas_, 441 U.S. 418,431-33 (1978). I would endorse use of that higher standard in Section 7, and thereby lessen the possibility that speculation would be used to decide the supposed future effects of the merger on competition.* In all other respects, I would leave Section 7 of the Clayton Act as it is now. I am not persuaded that the other proposed amendments of the Section would improve the law. Indeed, the other proposed changes, based upon proposed new standards, would tend to render inapplicable a substantial body of prior case law and might confuse the issue (of the potential effect of a merger), rather than clarify the subject.

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* _Compare_ _Kenford v. County of Erie_, ___ N.Y.2d ___ (May 6, 1986), in which the New York Court of Appeals addresses a similar legal problem -- that of speculation over prospective lost profits. In _Kenford_ the Court of Appeals rejected plaintiff's evidence, in support of plaintiff's demand for damages for lost future profits, as legally insufficient to establish "with reasonable certainty" the "loss of prospective profits for [plaintiff's] contemplated 20-year operation of a domed stadium which was to be constructed by defendant, County of Erie." The Court arrived at that decision even though plaintiff had introduced admittedly high quality evidence that "was in accord with contemporary economic theory and was presented through the testimony of recognized experts" and that represented "business and industry's most advanced and sophisticated method for predicting the probable results of contemplated projects."

New York, New York
May 19, 1986.

DISSENT

We dissent from the Committee's report because we do not agree with its fundamental premise that developments in enforcement practices and judicial decisions have cured the lack of reasonable standards to guide the courts in applying Section 7 of the Clayton Act or are sufficient to prevent future enforcement actions or judicial decisions that would frustrate potentially beneficial mergers. Section 7, as presently drafted, fails to provide a sufficient standard or adequate criteria by which a court can determine whether a challenged merger violates the law or does not. This vagueness of statutory language, which the Committee's report refers to as "flexibility," is the precise feature of the statute which permitted it to be invoked to bar potentially beneficial mergers.

However flexible District Courts and Circuit Courts of Appeals have been in applying prior Supreme Court decisions, and however restrained enforcement authorities may have become in applying recent developments in economic thinking, there is no assurance that future administrations and other courts will not revert to the enforcement policies and legal approaches of the past. The Supreme Court decisions handed down prior to United States v. General Dynamics Corp., 415 U.S. 486 (1974), remain the law of the land, and the majority report cites no reason why such decisions could not be applied to prevent potentially beneficial mergers as they were in the past. Nor, given the essentially standardless language of the present statute, is there anything in the statute to prevent enforcement officials or courts from developing some other equally undesirable approach in the future.

The Administration's proposal, while validly subject to some of the criticisms expressed in the Committee's report, does address the need for greater clarity in the standards to be applied by the courts and would with appropriate revisions make clear that Section 7 should be invoked only to prevent mergers that are likely to have a significant effect upon the nation's economy.

Richard E. Carlton
Thomas P. Griesa

DRESSER

June 2, 1986

The Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Dresser Industries, as an employer of your constituents, strongly urges you to markup S.2160, the Merger Modernization Act, at the earliest possible data.

This legislation has received strong support in three days of hearings before your Committee from the American Bar Association, academia and the business community. These experts presented compelling testimony on the need for this legislation. They pointed out that the Justice Department's merger guidelines are not the law, and therefore do not have to be followed by the courts. The legislation embodies into law these guidelines and it would enhance predictability by decreasing the risk of aberrational decisions and assure future certainty for corporate planning. Modernization of the antitrust laws will stimulate the competitiveness of U.S. firms without sacrificing protection for the American consumers.

With the limited number of days remaining in this session of Congress, fast action is imperative. We would very much appreciate your efforts to move this legislation forward.

Sincerely yours,

cc: Mr. Kenneth Starling
Washington, D.C.

June 9, 1986

The Honorable Strom Thurmond
Chairman, Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Senator Thurmond:

I write to express our warm support for S.2160, the Merger Modernization Act which you have introduced, now pending in the Judiciary Committee. The bill reflects the recommendations of the Administration's Cabinet Council and many other authorities that the nation's merger laws should be brought up to date to reflect modern day circumstances.

Today American companies operate in a worldwide marketplace and must continue to improve their efficiency in order to meet foreign competition. S.2160 would codify the current position of the Administration, courts and scholars that mergers should be evaluated in accordance with their effect on efficiency and worldwide competition. We therefore support the passage of S.2160 as a measure which will promote enhanced performance by U.S. companies in a world market.

Sincerely,

EXXON CORPORATION · 1251 AVENUE OF THE AMERICAS NEW YORK N Y 10020-1198

THE OFFICES OF
V. J. ADDUCI

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June 4, 1986

The Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Mack Trucks, Inc. strongly urges you to markup S.2160, the Merger Modernization Act, at the earliest possible date.

This legislation has received strong support in three comprehensive days of hearings before your Committee. Strong testimony was presented on the need for this bill from the business community, academia and the American Bar Association. It was clearly pointed out that the Justice Department's merger guidelines are not the law, and therefore do not have to be followed by the courts. The legislation will put into statute the guidelines, enhance predictibility, and assure future certainty for corporate planning. Modernization of the antitrust laws will stimulate the competitiveness of U.S. firms without sacrificing protection for the American consumers.

Fast action is imperative with the limited number of days remaining in this session of Congress. We would appreciate your efforts to move this legislation forward.

Very truly yours,

V.J. Adduci
Washington Counsel
Mack Trucks, Inc.

cc: John B. Curcio
Kenneth Starling

OWENS-ILLINOIS

David A. Ward
Senior Vice President Law
General Counsel

June 5, 1986

The Honorable Strom Thurmond
The United States Senate
218 Senate Russell Office Building
Washington, D.C. 20510

Dear Senator Thurmond:

Re: S.2160

We hope you will support S.2160 because mergers are now recognized to be a major way to improve the competitive capability of U.S. firms in worldwide markets in that they permit operations on a larger and more efficient scale.

Unfortunately, Supreme Court decisions which reflect an outmoded hostility toward mergers are still on the books and could be used in an effort to block worthwhile mergers. This level of uncertainty may deter the formation of more efficient merged enterprises. It is, therefore, desirable to update the merger laws as set forth in S.2160 to reflect current competitive and economic realities.

Please let me know if we can be of any assistance as you develop your position on this legislation.

Sincerely,

DAW/n

One SeaGate Toledo Ohio 43666 (419) 247 5169

PACIFIC TELESIS
Group

June 16, 1986

The Honorable Strom Thurmond
218 Russell Building
Delaware & Constitution Avenues, N. E.,
Washington, D. C. 20510

Dear Senator Thurmond:

I am writing you to urge prompt and favorable consideration by the Senate Committee on the Judiciary of S. 2160, the Merger Modernization Act of 1986. That Bill reflects an understanding of the changed worldwide marketplace since the passage, some 70 years ago, of section 7 of the Clayton Act and will serve to clarify and make more predictable existing merger law. Such clarification and predictability can do nothing but help American businesses compete aggressively and fairly both domestically and in international markets.

Sincerely,

Donald Guinn

United
States
Steel
Corporation

D. M. RODERICK
CHAIRMAN, BOARD OF DIRECTORS
& CHIEF EXECUTIVE OFFICER

PITTSBURGH OFFICE
600 GRANT STREET
PITTSBURGH, PENNSYLVANIA 15230
412/433-1101

June 12, 1986

The Honorable Strom Thurmond
United States Senate
Washington, D. C.

Dear Senator Thurmond:

We at United States Steel Corporation support the Merger Modernization Act, S. 2160, as a much needed and long overdue legislative enactment in the antitrust area to introduce a most sensible economic approach to this area of the law. For too long the area of mergers and joint ventures was governed by factors other than whether business ventures were pro-competitive. The antitrust laws in the merger area must help industrial concerns to become more efficient and lower cost producers in world markets.

I hope that you and your colleagues will favorably report the bill out to the full Senate and that it will receive favorable congressional action this year.

Very truly yours,

Donald E. Guinn
Chairman and
Chief Executive Officer

140 New Montgomery Street
San Francisco, California 94105
(415) 542 7661

PACIFIC TELESIS
Group

June 9, 1986

Honorable Strom Thurmond
United States Senate
Russell Senate Office Building 218
Washington, D.C. 20510

Dear Senator Thurmond:

I am writing in regard to Senate Bill 2160, the Merger Modernization Act.

We are supportive of S. 2160. It is our belief that this would significantly streamline the antitrust laws in a way that would improve the nation's economy.

Very truly yours,

D E Guinn

Chevron Corporation
225 Bush Street, San Francisco, CA 94104-4289

George M. Keller
Chairman of the Board

June 20, 1986

The Honorable Strom Thurmond
United States Senate
Washington, D.C. 20510

Dear Senator Thurmond:

I am writing to express Chevron Corporation's support of S.2160, the Merger Modernization Act, which I understand is currently awaiting markup by the Senate Judiciary Committee.

S.2160 would amend Section 7 of the Clayton Act, 15 U.S.C., Section 18, to establish as the basic test for judging the legality of a merger whether "there is a significant probability that such acquisition will substantially increase the ability to exercise market power." The bill then provides a definition of what constitutes the exercise of market power and enumerates a number of factors that courts should consider in evaluating the ability to exercise market power.

Chevron believes that the amendments contemplated by S.2160 will provide a much needed reform of merger law by clarifying and improving the analysis of mergers under the antitrust laws. It provides a framework and basis for such analysis by using language and embodying currently prevailing concepts derived from recent judicial precedents. In so doing, S.2160 should enhance the predictability of assessments of merger transactions and reduce the risk of aberrational judicial and administrative decisions with respect thereto.

These are among the reasons which prompt me on behalf of Chevron to urge that S.2160 be voted out of the Senate Judiciary Committee and brought to the floor of the Senate for consideration.

Yours very truly,

George M. Keller

Air Products and Chemicals, Inc.
Box 538
Allentown, PA 18105
Telephone (215) 481-7004

Edward Donley
Chairman

AIR
PRODUCTS

1986 JUL 11 AM 8:30

8 July 1986

The Honorable Strom Thurmond
Chairman, Committee
on the Judiciary
United States Senate
Washington, DC 20510

Dear Senator Thurmond:

We ask that you give expedited consideration to S.2160, the Merger Modernization Act, which is presently before your Judiciary Committee.

In my capacity as Chairman of Air Products and Chemicals, Inc. and also as Chairman of the U.S. Chamber of Commerce, I am particularly aware of the vital need for our country to respond to international competitive pressures. If our nation is to continue to thrive, it is imperative that we unshackle American business from outmoded and unduly restrictive legislation such as our country's present antitrust laws. These laws may be used to stifle mergers of business solely on the grounds that the combination would produce great efficiencies. At a time when America's productivity is lagging behind that of its foreign competitors, this just does not make sense. Our competitors for the world market are unhampered by similar rules.

In your capacity as Chairman of the Senate Judiciary Committee, I strongly urge you to schedule mark-up for the Merger Modernization Act as soon as possible.

Thank you very much.

Very truly yours,

Ed Donley

nlw

Honeywell

EDSON W. SPENCER
Chairman and Chief Executive Officer

1986 JUL 24 AM 9:01

July 18, 1986

The Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
SD-224 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Thurmond:

Honeywell supports the Administration's antitrust reform package which you introduced in March.

We realize that you are already publicly committed to this legislation. We are sharing Honeywell's full support for your efforts to add to the public record on this issue.

S. 2160, as you point out in your Congressional Record comments, only codifies existing policy. It is still a necessary piece of legislation, however, because older precedents may still be cited in the future to block mergers that could improve the worldwide competitiveness of U.S. firms.

Our position is shared by the Business Roundtable and is supported by testimony from the Chairman of the Roundtable's Antitrust and Government Regulation Task Force.

Sincerely yours,

Ed Spencer

EWSpencer:sh

Honeywell Inc., Honeywell Plaza, Minneapolis, Minnesota 55408, Telephone 612/870-5200